UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 67781 / September 5, 2012

INVESTMENT ADVISERS ACT OF 1940
Release No. 3456 / September 5, 2012

INVESTMENT COMPANY ACT OF 1934
Release No. 30193 / September 5, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15006

In the Matter of

RAYMOND J. LUCIA COMPANIES, INC. and RAYMOND J. LUCIA, SR.,

Respondents.

RESPONDENTS RAYMOND J. LUCIA, SR. AND RAYMOND J. LUCIA COMPANIES, INC.'S POST HEARING BRIEF

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Respondents Raymond J. Lucia, Sr. ("Lucia") and Raymond J. Lucia Companies, Inc. ("RJLC")(collectively, "Respondents") hereby respectfully submit their Post-Hearing Brief.

I. INTRODUCTION

The Securities and Exchange Commission ("Commission" or "SEC") instituted this proceeding on September 5, 2012, charging RJLC with willfully violating Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) promulgated thereunder, and Section 204 of the Advisers Act and Rule 204-2(a)(16) promulgated thereunder. Lucia is charged with willfully aiding and abetting and causing RJLC's violations of Sections 206(1), 206(2) and 206(4) of the Advisers Act, and Rule 206(4)-1(a)(5). The Order Instituting Proceedings ("OIP") against Respondents alleges violations of Sections 206 and 204 of the Advisers Act in connection with two illustrations in a PowerPoint presentation used as a backdrop by Lucia during seminars held to explain his retirement planning withdrawal strategy, "Buckets of Money" ("BOM"). Lucia has presented his BOM retirement withdrawal strategy at hundreds of seminars to more than 50,000 attendees throughout the country for almost two decades. In asserting securities violations against Respondents, the SEC and the Division of Enforcement ("Division" or "Enforcement") have ignored entirely the context in which the PowerPoint slides were presented. There were 39 BOM seminars in 2010, including 30 which occurred after the fieldwork for the SEC's 2010 examination of RJLC had commenced, eight of which were in southern California. Instead of taking the opportunity to see a BOM seminar or ask Lucia any questions regarding the content of any slide, the SEC and Division assess the slides in a vacuum in order to construct misrepresentations where none exist. Attempting to decipher the content of the slides without Lucia's accompanying narration is challenging at best, and as interpreted by the Division, a fundamental distortion of the facts.

In its prosecutorial fervor to assert claims for activities as to which the **SEC has admittedly issued no guidance or opportunity for public comment**, the Division strains to apply Sections 206 and 204 in a manner that has never been articulated or addressed in any reported decision; is a sea change to current industry standards; and would violate Respondents' due process rights to fair notice of regulatory requirements.

At issue are two hypothetical illustrations which comprise approximately five minutes of a two hour BOM seminar. The Division alleges that these slides are misleading, that the slides are performance advertising and Respondents' use of the slides is so egregious, that the 38 year discipline free career of Lucia, his family business and the livelihoods of his employees should summarily end. The evidence presented at hearing and the applicable legal authority dictate that the Division's case fails at every level.

First, the February 2009 Webinar ("Webinar")[1] of a BOM seminar conclusively demonstrates that the seminar attendees understood that the illustrations at issue were hypotheticals, the purpose of the illustrations – a comparison of the BOM withdrawal strategy to other withdrawal strategies, and that the illustrations were not making securities recommendations or advertising a model portfolio or managed account.[2] The Webinar, and other evidence presented by Respondents, categorically establishes that a reasonable investor could not be misled. The Division's desperate attempt to disregard the context in which the seminar slides were presented, including a strenuous, unsuccessful challenge to the admission into evidence of the Webinar, the best evidence of the presentation made to seminar attendees, is telling. Even

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[1] Respondents' Exhibit 30. The Division's Exhibits and Respondents' Exhibits will be cited herein as "DX __," and "RX __." The hearing transcript will be cited as "Tr. __."

[2] The disclosures on the slides at issue, and dozens of others in the slide presentation, clearly state that the scenarios presented are a **"hypothetical illustration."**

Clover Capital Management ("*Clover*")[3], a no-action letter the Division uses as some form of "authority" (since the SEC has provided no guidance on performance advertising), requires that the "total context" of an advertisement be considered to determine whether it is misleading. A review of the Webinar also explains why Respondents, the SEC, RJLC's supervisory broker dealers Securities America and First Allied Securities, and FINRA **never received a single complaint** from a seminar attendee concerning the BOM seminar or slideshow.

Second, the slideshow illustrations the Division claims are the basis for a professional death sentence for Respondents were examined by the SEC in 2003 and the examiners **raised no concerns or issues**. Notably, the SEC examiners for the 2003 examination of RJLC also concluded that RJLC was **not engaged in performance advertising.**

Third, the illustrations at issue are not "back-tests" as the Division and its expert now define that term – an evolving and publicly unannounced definition which is at variance with recognized industry standards and appears to have been designed specifically for this proceeding. The hypothetical illustrations at issue could not have been "back tests" in the technical sense the Division seeks to apply as an investor could not have made the "investments" the illustrations describe, i.e. an investment in the S&P 500, an unmanaged index.[4] The Division asserts that the slides are misleading for utilizing a 3% inflation rate; a hypothetical REIT rate of return, failure to deduct advisory fees and failure to reallocate investments. As established by the evidence at the hearing, the inflation rate and REIT rate of return, which were fully disclosed during the seminar as "assumed" and "hypothetical," are reasonable and not misleading; deduction of advisory fees from the illustrations would have been impossible and therefore, purely

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[3] *Clover Capital Management, Inc.*, 1986 WL 67379 (SEC No Action Letter Oct. 28, 1986).

[4] The PowerPoint slides specifically disclose, "Stocks are represented by the S&P 500 an unmanaged index representative of the stock market in general" and that an investment may not be made directly in an index. RX 3, SEC-LA3937-00161-65, 168-69, 200.

hypothetical and misleading; and reallocation of investments was premature and inconsistent with the purpose of the illustrations. Importantly, Respondents offered unrebutted evidence that detailed information concerning each of these issues was communicated to potential investors who chose to meet with a RJLC advisor.

Fourth, the unrebutted evidence demonstrates that in addition to the SEC expressing no concern regarding the slides during the 2003 examination, the slides were subjected to multiple layers of compliance review over the past decade. The slides were reviewed by two broker dealers, Securities America and First Allied Securities, and RJLC's internal compliance department. No concerns were ever raised that the slides might be misleading and any revisions requested by the broker dealers were made.

Respondents anticipate that the crux of the Division's argument will be that had Respondents applied the inflation rates, REIT rates and advisory fees advocated by their expert, instead of having $4.7 million in assets at the end of 38 years, as represented by the seminar slides, the asset value would be zero. Notwithstanding as shown, *infra*, that the inflation and REIT rates the Division proposes are inherently flawed, the Division's complaints about the seminar slideshow intentionally ignore the content, context and clear purpose of the slides – when applying the same assumptions across multiple scenarios, the BOM strategy lasted longer. In sum, no reasonable investor was or could have been misled into believing that he or she could replicate the investments as presented and end up with $4.7 million when he or she was 103 years old.

Moreover, when the precedential legal authority and language of the statutes is applied to the claims, the Division's case collapses. First, there is **no precedent** for finding that the BOM seminar slides are performance advertising as neither the illustrations at issue nor the BOM

withdrawal strategy are model portfolios. The illustrations at issue do **not** advertise the performance of any managed account or any securities recommendation, but instead compare the asset longevity of the BOM retirement withdrawal strategy to other retirement withdrawal strategies. The parameters of *Clover* do not even begin to encompass a retirement withdrawal strategy that does not identify any specific security, portfolio, fund, account or asset that a potential investor could purchase. RX 3, RX 30, DX 66. In accordance with two recent Supreme Court cases, *FCC v. Fox Television Stations, Inc.* 567 U.S. ___, No. 10-1293 (U.S. June 21, 2012) and *Christopher v. Smithkline Beecham Corp.* 567 U.S. ___, 132 S. Ct. 2156 (2012), the SEC cannot "require regulated parties to divine the [SEC's] interpretations in advance or else be held liable when the [SEC] announces its interpretations for the first time in an enforcement proceeding and demands deference." *Christopher, supra,* 132 S. Ct. at 2168. These cases conclusively demonstrate that this proceeding violates Respondents' due process rights.

Second, the well-established legal standard for materiality is not met here as the purpose of the seminar illustrations was not to have attendees make an investment decision – no investments are offered or recommended at BOM seminars. Instead, the attendees are given the opportunity to be contacted by a RJLC advisor at a later date and receive a BOM plan.

Third, with respect to the Division's assertion that RJLC violated Section 204 (Books and Records) of the Advisers Act, that allegation also fails. The slides do not in any way calculate the "performance or rate of return of any or all managed accounts or securities recommendations" as Rule 204-2(a)(16) requires. Therefore, RJLC was not required to maintain or provide support for the calculations contained in the slides. The Division's allegation that RJLC was required to maintain books and records to demonstrate the performance of a hypothetical illustration comprised of investments in the S&P 500 index (an investment cannot

be made directly in an index); an unspecified real estate investment, and unidentified T-Bills defies a rational interpretation of Rule 204-2(a)(16) and every reported decision, no-action letter and order making findings that has interpreted Section 204.[5]

The Division had two years to conduct an investigation of Respondents and is the master of its claims. The OIP contains no claims that Lucia's books, radio show, the BOM strategy, other marketing materials, method of compensating advisers, products sold – including REITs, commissions, disclosures or RJLC's corporate structure violate any securities law. Instead, the OIP asserts violations based exclusively on two PowerPoint illustrations. The majority of the evidence presented and testimony elicited by the Division during the hearing had no more than a tangential, at best, relationship to the allegations in the OIP. Finally, the Division's substantial reliance to support its case on two spreadsheets produced by RJLC is misplaced. As shown below, because the slides at issue were not calculations of the performance of a managed account or securities recommendation, RJLC was not required to maintain any books or records regarding the calculations. Accordingly, the spreadsheets, which were never disseminated to the public, cannot be the basis for the securities violations alleged.

Following the Staff's March 2010 examination of RJLC and upon receipt of the December 17, 2010 deficiency letter concerning, among others things, the seminar slides, Respondents immediately ceased all use of the slides at issue and distribution of Lucia's books. This is a matter that should have been resolved through the examination process, as Respondents thought it had been and as the SEC examiner, Branch Chief, Assistant Regional Director and Associate Regional Director originally concluded. RX 50. The disciplinary sanctions the

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[5] Moreover, the slides at issue were not "circulated" or "distributed" (terms that are not defined in the Regulations) to any investor or potential investor. *See* Rule 204-2(a)(16) *see also* 206-4-1(a)(5). There do not appear to be any reported decisions where the SEC has taken the position that PowerPoint slides from a seminar which were not circulated or distributed to the seminar attendees are encompassed within the definition of Rule 204(4)-2(a)(16) or Rule 206(4)-1(a)(5).

Division seeks, revocation of registration, industry bar and civil penalties of nearly $1,000,000 are the *pièce de résistance* of this affront to justice. Although the SEC communicated no concern as to the same slides ten years ago; the SEC made no effort from March 2010 through December 2010 to stop the seminars or "protect" potential investors; the SEC admits no investor has complained about a BOM seminar; the Division does not assert that a single investor lost a dime as result of a seminar presentation; and Respondents have a spotless disciplinary record,[6] the Division asks for sanctions that would befit the mastermind of a massive Ponzi scheme. The requested sanctions, which bear no relationship to Respondents' conduct, expose the Division's bid to manufacture securities violations where none exist. By bringing this action, the Division has critically damaged the professional reputation of Lucia and severely impaired damaged his business, thus jeopardizing the livelihoods of scores of employees, many of whom have worked with Lucia for decades. Only vindication can restore Respondents' reputation and future.

II. FACTUAL BACKGROUND

Lucia is 62 years old and resides in San Diego, California. Tr. 1024. Lucia is the creator of the "Buckets of Money" retirement withdrawal strategy. Tr. 724-25, 1024, 1048, 1050.[7] Lucia is currently an investment adviser representative registered with RJL Wealth Management, LLC ("RJLWM") and the host of The Raymond Lucia Show, a syndicated radio and TV show. Tr. 1024-5. Lucia has been advising clients as to retirement planning since 1974. Tr. 1031-32.

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[6] Neither Lucia nor RJLC have ever been fined or disciplined by the Commission or any other regulatory body, nor the subject of any prior disciplinary action. Tr. 1307.

[7] According to the Financial Planning Association, the bucket strategy is now used by almost one-third of financial professionals. RX 41.

Lucia has authored three books on the topic of retirement and the BOM strategy.[8] Tr. 1029. The OIP does not contain any allegations that any of these books is false or misleading.[9]

Lucia founded RJLC in 1994. Tr. 1026. In 2010, the assets of RJLC were sold to Ray Lucia, Jr. ("Lucia, Jr."). Tr. 1027. SEC examiner Brian Bennett ("Bennett") was advised by Lucia during the initial interview for the 2010 examination of RJLC that RJLC was going to be sold to Lucia, Jr. and that RJLWM would assume the advisory contracts of the RJLC clients. Tr. 74.[10] Lucia sold RJLC because he wanted to focus on his media career as a radio and television host and spokesperson and had had not actively worked with clients or been involved with the management of RJLC for the prior decade. Tr. 507-508, 1071-72. Lucia, Jr. began running the back office and managing RJLC in 2003. Tr. 1071, 1501-02, 1599-1600.

In its simplest terms, the BOM retirement withdrawal strategy is a liability driven concept where "assets are matched to liabilities;" "short term investments are used to fund a current short term need for income;" mid-term investments provide stability; and "long-term investments provide growth for potential long term financial goals." RX 3, SEC-LA3937-00179, RX 30-33. The BOM strategy advocates investing in a "safe bucket" for initial spending needs during retirement and a long-term "growth bucket" to build retirement income to be spent after the safe bucket is depleted some years in the future, depending on each individual retiree's circumstances. Tr. 725-729; RX 3, SEC-LA3937-00181, RX 30-33. Due to the short and

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[8] *Buckets of Money® How to Retire in Comfort & Safety* (Wiley & Sons, 2004), *Ready. Set. Retire! Financial Strategies for the Rest of Your Life* (Hay House, 2007), and *The Buckets of Money® Retirement Solution – The Ultimate Guide to Income for Life* (Wiley & Sons, 2010). RX 31, RX 32, RX 33.

[9] Notwithstanding the fact that the OIP does not contain any allegation that the books contain any misrepresentation or violate any section of the Advisers Act or any securities law, the Division spent an inordinate amount of time during the hearing selectively referring to passages from the books. A review of each of the books demonstrates extensive disclosures and discussion concerning the issues the Division alleges Respondents failed to disclose. Similarly, the OIP does not include any allegation that Lucia's website or radio or television appearances in any way violate the Advisers Act or any other securities law.

[10] RJLWM and Lucia, Jr. were also investigated by the Division following the 2010 Exam and the Division determined that no charges against RJLWM or Lucia, Jr. were warranted.

intermediate term nature of fixed income investments, many times three or more buckets are used: Bucket 1 for immediate income (and depending on assets and outside income sources, and lifetime annuitized income), Bucket 2 to replace Bucket 1 after a specified period and Bucket 3, the long term growth bucket, consisting of diversified stocks and real estate investments with an approximate fifteen year time horizon.[11] *Id.* The BOM withdrawal strategy encourages, but does not require, investors to spend down Buckets 1 and 2 first, thereby allowing the investments in Bucket 3 to grow. *Id.* Under the BOM strategy, the longer the investments in Bucket 3 have to grow, the lower the risk of having to take distributions from a volatile portfolio during and after substantial declines in the stock market. *Id.* The BOM strategy is, for example, an alternative to the systematic withdrawal and rebalancing approach utilized by many investment advisers.[12]

Lucia developed the BOM strategy, in part, as a result of reviewing a number of studies including a 1998 article from the Journal of Financial Planning entitled, "A Retirement Dilemma" which includes historical financial data from Ibbotson & Associates and Dow Jones for the period 1972 to 1997 and discusses the effect of taking retirement withdrawals in volatile markets. Tr. 1037-39, 1319, DX 80. Subsequent to Lucia's creation of BOM, a significant number of investment advisers, academics and economists have begun advocating versions of the "spend safe money first" BOM strategy.[13] The SEC examiners reviewed the BOM strategy

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[11] The BOM strategy does not require three buckets. Tr. 893. Because each RJLC client has a BOM plan unique and individual to their assets and goals, a BOM plan could have as few as two buckets or more than ten. Tr. 892-93.

[12] The traditional asset allocation and systematic withdrawal and rebalancing strategy sets the client's portfolio to a specific diversification allocation – 60/40 equities to fixed income is the classic example – and income withdrawals are managed around that standard.

[13] *See*, S. Singh, J. Spitzer. 2007. "Is Rebalancing a Portfolio During Retirement Necessary?" *Journal of Financial Planning*, June 2007 (RX 37); R. Irons, R. Wigand. 2008. "How Withdrawal Sequence Affects the Longevity and Risk of Retirees' Portfolios: Additional Evidence." *Journal of Financial Planning*, November 2008 (RX 38). These articles, which offer empirical evidence to validate the BOM strategy, were reviewed and relied on by Lucia. Tr. 1154-57; RX 7. *See also*, Fox, N. 2012. "A Bucket Strategy for Retirement Income." *Forbes*, May 9, 2012 (RX 41).

and determined there were no deficiency issues with it. Tr. 105-6. Further, the Division's counsel specifically advised this court that the Division was not "challenging the validity of the Buckets of Money strategy." Tr. 25.

Lucia presents the BOM strategy during retirement distribution planning seminars held throughout the country, illustrating that the concept of withdrawing bonds or other safe investments over stocks or "safe money first," is a better method than the traditional method of taking income from a more volatile portfolio and rebalancing the portfolio periodically. Tr. 1058. The BOM strategy is readily distinguishable from, for example, advertised performance results based on client accounts or market timing models which show specific rates of return for specific time periods based on hypothetical mutual funds.

A. Lucia's BOM Seminar Presentation

The BOM seminars are free seminars featuring Lucia and marketed to retirees and those approaching retirement. Tr. 233, 1060, 1068. From 2003 to 2010, more than 50,000 people have attended. Tr. 1061. The goal of the BOM seminars is to attempt to match up a potential investor with a financial advisor who will gather extensive financial information from each individual,[14] prepare a custom, individualized BOM plan, discuss and disclose the risks of the various investments, give the potential investor ample time to make investment choices and ultimately become a client of the firm. Tr. 572-73, 1072, 1286, 1559. **During the seminar presentations, Lucia does not promote or sell any specific stock, bond, mutual fund, annuity, real estate investment, or managed portfolio and does not make any promise or prediction as to the return on any investment portfolio.** Tr. 142, 571-72, 1274, 1281, 1284, 1594, 1597.

[14] Prior to preparing a BOM plan, a RJLC advisor gathers and reviews documentation including, investment statements, tax returns, estate planning documents and current income information. Tr. 1559-1560.

During the BOM seminars, Lucia uses a PowerPoint presentation ("slideshow" or "PowerPoint") and also manually draws illustrations on an overhead projector. Tr. 1063, 1153, 1226; RX 3, RX 30. The majority of the BOM seminar, including the slideshow, is educational in nature, setting forth factors and risks relative to retirement planning.[15] Tr. 1281, 1553; RX 3, SEC-LA3937-00092-170, RX 30, 00:00-41:55. Following an in depth discussion of market and investment risks for investors generally and retirees specifically, Lucia manually draws out a pie chart representing the systematic withdrawal and rebalancing strategy which withdraws assets from a volatile portfolio. DX 66, 28:6-29:1, RX 30, 26:16-27:15. Lucia then introduces the BOM withdrawal strategy by manually drawing out "an oversimplified version" of BOM using a two bucket illustration to demonstrate spending safe money over volatile assets. DX 66, 29:2-30:6, RX 30, 27:18-28:37.[16]

After introducing the BOM strategy, Lucia presents three comparison withdrawal strategies, namely 1) a conservative strategy where the investors, identified as the "Conservative Campbells" invest 100% in "safe" investments, CD's, money markets, bond funds, etc.; 2) a risky strategy where the investors, identified as the "High Rolling Hendersons" invest 100% in the "stock market"("100% Stock Portfolio"); and 3) a "balanced" strategy where the investments are 60% stocks and 40% bonds and withdrawn proportionately ("60/40 Stock/Bond Portfolio"). Tr. 1098-1100; RX 3, SEC-LA3937-00150-170; RX 30, 37:23-41:54. For these illustrations,

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[15] During the BOM seminars, Lucia discusses Investment Risk, Stock Market Risk – Growth of a Dollar, Volatility Risk, Risk of Stock Market Loss, Interest Rate Risk, Inflation Risk, Tax Risk, Event Risk, Past Bear Markets, Recessions, Longevity Risks, Dangers of Market Timing, Market Timing Newsletters, Fundamental Analysis, Technical Analysis, Financial Magazines, Main Street Gets It Wrong, Gurus, Reverse Dollar Cost Averaging, Asset Class Returns, Correlations, Real Estate, Diversification to Reduce Risk, and Standard Deviation. RX 3, SEC-LA3937-00097-149.

[16] Following these illustrations, Lucia quotes from two studies, Singh, J. Spitzer. 2007. "Is Rebalancing a Portfolio During Retirement Necessary?" *Journal of Financial Planning* June 2007, and a study by Reinhart Werba Bowen/Ibbotson/Dow Jones as academic and empirical support for the BOM strategy. RX 30, DX 80.

each strategy begins with a $1 million portfolio, withdraws $60,000 annual income, **assumes a 3% inflation rate** and invests and withdraws funds in accordance with the particular strategy. RX 3, SEC-LA3937-00150-170; RX 30, 37:23-41:55.

For the 100% Stock Portfolio and 60/40 Stock/Bond Portfolio, Lucia then discusses how those strategies would have fared **if the investors' retirement date began on January 1, 1973** when the stock market declined "41.13% Over 2 Years."[17] Tr. 767, RX 3, SEC-LA3937-00161-170, RX 30, 39:37-41:54. In describing the High Rolling Henderson's retirement date, Lucia states:

> **Let's pretend for a minute that the Hendersons retired January 1, 1973.** One of those last big bear markets. **Of course, it could have been January 1, 2000 or God help us, January 1 in the year 2008.** Nonetheless, back in 1973, remember the stock market dropped forty-one percent or so over the next two years. It took forty-three months to get back to even. And back then, it took 12.8 years . . . 12.8 years, for an investment in the stock market to have equaled the return of T-bills . . . T-bills; 12.8 years. RX 30 39:35-40:27, DX 66 40:20-41:11, RX 3, SEC-LA3937-00161-65.

This statement demonstrates the hypothetical nature and context of the three illustrations, including the BOM illustration discussed below, which focus on the effect of a bear market on the withdrawal strategies. **If one were only to view the slides in a vacuum and did not hear Lucia's presentation or see the BOM illustrations he manually depicted during the seminars, as the Staff and Division deliberately ignored, it would be difficult, if not impossible to understand the purpose of these illustrations.**

Following these illustrations, Lucia provides a more detailed explanation of the BOM strategy and uses illustrations to demonstrate that changing one factor, spending safe money over volatile money, creates positive results in comparison to the other withdrawal strategies. Tr. 738, RX 30, 41:55–45:57, RX 3, SEC-LA3937-00171-198. Lucia also introduces the advantages of

[17] The purpose of these illustrations is to demonstrate how the 100% Stock Portfolio and the 60/40 Stock/Equity Portfolio would have performed during a steep market decline or bear market at the beginning of retirement.

adding direct ownership in real estate including REITs, as part of a BOM plan and presents a slide listing long-term real estate investment risks, disclosures and assumptions. *Id.* RX 3, SEC-LA3937-00180. Again, trying to interpret these slides without Lucia's commentary is problematic at best, and as interpreted by the Division and its expert, a fundamental misinterpretation of the facts. RX 3, RJL-SEC-0000161-170, 199-201, RX 30, 39:37-41:53, 45:58-46:45, DX 40:20-42:23, 46:14-47:14.

The sole basis for the allegations in the OIP are two hypothetical illustrations that follow. The first illustration demonstrates for the seminar attendees how the BOM withdrawal strategy, with investors identified as "Bold Bucketeers," performs in comparison to the 100% Stock Portfolio and the 60/40 Stock/Bond Portfolios assuming the Bold Bucketeers also retire in 1973 during the "Grizzly Bear" market ("'73 Illustration"). OIP, ¶ 17; Tr. 767-769, 840, 1097-98; 1547; RX 3, SEC-LA3937-00161-170, 199-201; RX 30, 37:23-47:00; DX 40:20-42:23, 46:14-47:14, see also, RX 51, LA-SEC3937-005812.[18] For the '73 Illustration, the seminar attendees are told that the market conditions are identical to those articulated for the 100% Stock Portfolio and the 60/40 Stock/Equity Portfolio, namely, retirement on January 1, 1973, $1 million retirement portfolio, $60,000 annual income withdrawal, and a 3% assumed inflation rate. Tr. 767, RX 3, SEC-LA3937-00199-201; RX 30, 45:58-46:45, DX 46:14-47:14. The '73 Illustration demonstrates that by withdrawing retirement assets in accordance with a BOM withdrawal strategy, the income lasts for a longer period of time and, therefore, the BOM strategy is superior to the comparison strategies. *Id.* see also, RX 51, LA-SEC3937-005812, fn.7. Without the benefit of hearing Lucia's explanation of the '73 Illustration, including its components and

[18] In its December 2010 Exam Report, the staff acknowledges "[t]he seminar presentation also included several hypothetical performance scenarios that compared non-Buckets of Money portfolios against a Buckets of Money portfolio." RX 51, LA-SEC3937-005812.

purpose, it would be pure guesswork for someone simply reviewing the PowerPoint slideshow to determine the context.

The purpose of the second hypothetical illustration at issue is to compare the efficacy of the BOM withdrawal strategy to the 60/40 Equity/Stock Portfolio withdrawal strategy during a period of prolonged stagnant stock market returns ("'66 Illustration"). OIP, ¶ 17; Tr. 772, 1097-98, 1547; RX 3, SEC-LA3937-00202-211; RX 30, 47:21-50:36, DX 66, 47:15-51:19, RX 51, LA-SEC3937-005812. The impetus for the '66 Illustration was a conversation Lucia had with economist, Ben Stein during which the assumptions for the '66 Illustration were determined. Tr. 1268, 1687.[19] During the seminar, Lucia relates the conversation to the attendees and states – "you remember how in 1966, the Dow Jones Industrial Average was hovering around 1,000 and in 1982, the Dow was still at about 1,000" – to describe why the particular time frame is being highlighted. RX3, SEC-LA3937-00202-211; RX 30, 47:21-50-36, DX 60, 48:9-14. As with the '73 Illustration, the '66 Illustration produced greater returns for longer periods of time in comparison to the 60/40 Equity/Stock Portfolio withdrawal strategy. RX 3, SEC-LA3937-00202-211; RX 30, 47:21-50-36, DX 66, 47:15-51:19.

As discussed in greater detail, *infra*, the fact that the '73 and '66 Illustrations are forward-looking and not "back-tests" and were clearly understood as such by the seminar attendees is borne out by the numbers utilized in the Illustrations. Each factor used in the Illustrations, $1 million "nest egg," withdrawal of $60,000 in annual income, and 3% assumed inflation rate, is forward looking.[20] The BOM seminar attendees are those in or nearing retirement. Tr. 233, 338,

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[19] During the seminar, while the slide titled "Notes and Assumptions" is displayed, Lucia states, "Now, once again, these are the assumptions that we used with Ben Stein." RX 30, 47:33-47:38, DX 66, 48:4-6. These assumptions include a 3% inflation rate and a 7% REIT return rate. RX 3, SEC-LA3937-00204.

[20] Grenadier's Report acknowledges that a $1,000,000 portfolio and $60,000 income withdrawal bear no relation to the average portfolio and incomes in 1966 or 1973. Average household wealth in 1962

1060. As such, BOM seminar attendees in 2010 were alive and most likely in the workforce in 1973. They knew there was double digit inflation in the 1970s and could recall that the median family income in 1973 approximated $10,000. Therefore, the portfolio of $1 million and the income withdrawal of $60,000 that was used for all five illustrations, was obviously a forward-looking (or present day) withdrawal, not what a retiree would have experienced in 1973.

The '73 and '66 Illustration slides are not crucial to the BOM presentation and comprise less than five minutes of a two hour seminar. Tr. 1277, RX 30. **This is proven by the fact that after RJLC ceased using the '73 and '66 Illustration slides in the PowerPoint presentation, the response rate of seminar attendees who filled out a response card to meet with an RJLC advisor did not decline. Tr. 1633-34.**

Finally, the BOM PowerPoint presentation ends with Lucia manually drawing out a sample BOM plan. RX 30, 53:24-1:10:45, DX 66, 53:2-69:5. During this portion of the seminar, Lucia discusses fees, inflation, reallocation, dividends and real estate investments. *Id.* This is the most in-depth description of how the BOM strategy works, but **only the seminar attendees**, not the SEC examiners or the Division, had the opportunity to consider this material. Immediately after the PowerPoint presentation, Lucia and other professionals field questions from the seminar attendees. Tr. 281-82. Again, considering the PowerPoint presentation without context, namely, without Lucia's narration and the manually drawn illustrations, does not accurately reflect the information communicated to the seminar attendees.

At the conclusion of the seminar, attendees are invited to submit contact information to be contacted on a later date by a RJLC adviser. Tr. 1559. Approximately 50% of the attendees choose to be contacted. Tr. 1633. If an attendee later meets with an adviser, he/she will be given

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was $38,782 and in 1973 was $61,563; median income in 1967 was $7,143 and in 1973 was $10,512. See DX 70, fn. 3 and 4.

a complementary BOM plan specific to his/her personal goals, objectives and investment circumstances and based on financial information provided by an attendee to a RJLC adviser. Tr. 1559-62. Until a potential investor meets with a RJLC adviser and develops a BOM plan, typically 3-4 weeks following a seminar, there is no discussion as to any specific investments or allocations. Tr. 1282. On average, it takes 207 days from the time a seminar attendee fills out a contact card until the time a percentage of the attendees become clients. Tr. 1285.

B. The February 2009 Webinar

On February 16, 2009, Lucia aired a BOM seminar via the Internet. RX 30, 62. Indisputably, the Webinar is the best evidence of the BOM seminar presentation and the only opportunity for the Division and the court to consider the context in which the '73 and '66 Illustration slides were presented. Not surprisingly, given the SEC examiners' conscious refusal to attend a BOM seminar and the Division's refusal to provide a copy of the Webinar to its expert, the Division argued strenuously to exclude admission of the Webinar into evidence. Tr. 148, 963-964. The Division's attempt to prevent this court from considering the Webinar, **the only recorded example of a BOM seminar,** is both surprising and troubling, and can only be interpreted as a concession that the Division's case hinges on this Court ignoring the context in which the slideshow illustrations were presented. Moreover, the Division's position is revealing as the Webinar absolves Respondents of liability for the asserted Rule 206 violations.[21]

First, the Webinar proves that a reasonable investor would understand that the '73 and '66 Illustrations were hypotheticals, not "back-tests" as that term is now used by the SEC and its expert. Second, the Webinar proves that a reasonable investor would understand that Lucia was not using the actual annual rate of inflation for the 1973-2003 and 1966-2003 time periods and

[21] One would have hoped that the Division would be more interested in the truth than the destruction of a man and the business he built over 38 years.

that the actual inflation rate was higher by his statement, **"and let's pretend that from this point forward [1966], inflation was three percent. We know it was more but we wouldn't have known that at the time."** RX 30, 39:37-40:27, DX 66, 48:21-49:2. This statement also demonstrates that a reasonable investor would understand the '73 and '66 Illustrations were forward looking and not back-tests.

Third, the Webinar proves that a reasonable investor would understand that the specific purpose of the '73 Illustration was to compare the results of the BOM withdrawal strategy to the illustrations where the 100% Stock Portfolio and the 60/40 Stock/Bond Portfolio investors also retire in 1973. RX 3, RJL-SEC-0000161-170, 199-201, RX 30, 39:37-41:53, 45:58-46:45, DX 40:20-42:23, 46:14-47:14. In these comparison illustrations, a 3% assumed inflation rate is also applied and fully disclosed. *Id.* The Webinar also proves that a reasonable investor would understand the purpose of the '66 Illustration was to compare the results of the BOM withdrawal strategy to the illustration where the 60/40 Stock/Equity Portfolio investors also retire in 1966. RX 3, SEC-LA3937-00202-211; RX 30, 47:21-50:36, DX 66, 47:15-51:19, RX 51, LA-SEC3937-005812. The Division presented no evidence to rebut Respondents' testimony that even assuming the actual historical rates were applied to the '73 and '66 Illustrations, BOM still outperformed the comparison strategies.[22] In sum, the Webinar conclusively demonstrates that the purpose of the '66 and '73 Illustrations was to show the superiority of the BOM withdrawal strategy, not to mislead a potential investor into believing Lucia was promising a specific ending balance at the end of a particular time period.

Respondents urge this court to again review the Webinar prior to issuing a decision.

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[22] See, RX 51, LA-SEC3937-005814, fn. 8.

C. The 2003 SEC Examination of RJLC

On August 23, 2003, Laura Coty ("Coty"), SEC Staff Accountant and Securities Compliance Examiner contacted Melissa Dotson ("Dotson") of RJLC[23] and advised her that the SEC's Pacific Regional Office would be examining RJLC the following week ("2003 Exam"). Tr. 1478-1479. In connection with the 2003 Exam, the Staff requested records from RJLC, including "relevant information that documents and substantiates the effectiveness of controls and compliance procedures with the objective that 'Performance information used in advertisements and other marketing materials is calculated accurately and fairly and is used in ways that is not misleading.'" Tr. 1480-81, RX 15, p. 11, I.B.7. With the assistance of its supervising broker dealer, Securities America, RJLC responded that this section regarding performance advertising was "not applicable." Tr. 1480-81, RX 16. The SEC examiners never questioned RJLC's response. Tr. 1481. Further, as discussed below, the 2003 examiners specifically concluded that RJLC **"does not advertise performance."** RX 22, SEC-LA3937-1027.

As part of the 2003 Exam, the SEC requested a copy of RJLC's promotional and advertising materials Tr. 1479-1480; RX 15. In response, RJLC made available and the examiners reviewed RJLC's advertising materials, including Securities America's compliance approval for some of the BOM seminar slides used in 2003. Tr. 1482-83. After seeing these materials, Coty asked Dotson to provide the BOM seminar PowerPoint presentation so she could review it in its entirety. *Id.* In response, Dotson provided Coty with the BOM seminar PowerPoint presentation on a laptop in a conference room. *Id.* Dotson identified Division Exhibit 21 as the PowerPoint presentation she provided to the SEC examiners during the 2003

[23] Dotson began working with Lucia in 1975 and is the former chief operating officer of RJLC. Tr. 1474-75. Dotson was RJLC's contact person for the SEC's 2003 Exam. Tr. 1481-2.

Exam. Tr. 1484. The Division presented no evidence that the SEC examiners did not see the entire PowerPoint presentation during the 2003 Exam.

The seminar slides that the Staff examiners reviewed during the 2003 Exam have the exact issues the Division now contends are the basis for the OIP. The 2003 examiners, however, passed on these slides without comment. Tr. 1485-87. Specifically, the 2003 slides include the '73 Illustration labeled "back test." Tr. 1485-87; Compare RX 3, SEC-LA3937-00461 to DX 21, SEC-LA3937-01094. The 2003 slides also assume a 3% inflation rate for a historical time period commencing in 1973, a 7.75% REIT dividend yield for the same period, do not deduct advisory fees and do not reallocate assets. DX 21, see DX 21, SEC-LA3937-01082-1086, 1090-91, 1093-1095, **compare** RX 3, SEC-LA3937-00161-170, 199-201; RX 30, 37:23-47:00; DX 40:20-42:23, 46:14-47:14.

After reviewing the PowerPoint presentation, the 2003 SEC examiners expressed no concern regarding the use of the term "back-test" or the "73 Illustration. Although the 2003 examiners requested copies of certain slides from the 2003 PowerPoint presentation, they did not request copies of the slides with the issues now complained of in the OIP. Tr. 1487-1491; RX 17, 18, 19. The 2003 examiners also received a copy of Lucia's book, *Buckets of Money® How to Retire in Comfort & Safety*, and expressed no concern regarding the content. Tr. 1493-94. The December 12, 2003 deficiency letter sent to RJLC following the 2003 Exam makes no mention of the seminar slide presentation and **takes no issue with the term "back test," the use of an assumed 3% inflation rate for a historical period 1973-2003, use of a 7.75% REIT dividend, failure to deduct advisory fees or failure to reallocate.** Tr. 1486-87. RX 13. Most importantly, the Investment Adviser Examination Report for the 2003 Exam of RJLC ("2003 Exam Report") states:

> . . . Second, **because Registrant does not advertise performance**, the staff excluded performance advertising from the scope of the examination. Third, because Registrant is not responsible for placing or executing orders with respect to managed client accounts, the staff did not review personal securities transactions. RX 22, SEC-LA3937-1027.

The 2003 Exam Report also states, "In addition, Lucia conducts seminars, radio broadcasts, and television appearances nationwide on general investment and financial planning and the Buckets of Money strategy." RX 22, SEC-LA3937-1034. In 2003, after examining the same seminar slides as the '73 Illustration and considering the BOM seminars, the Staff concluded that RJLC **did not advertise performance** and the '73 Illustration slides did not violate securities laws. *Id.*[24]

D. 2010 Examination And Enforcement Action

In March 2010, the SEC's Pacific Regional Office conducted a subsequent examination of RJLC and RJLWM. Tr. 61, RX 50, RX 51 ("2010 Exam"). The 2010 Exam covered the period January 1, 2008 through January 31, 2010. RX 50, RX 51. The 2010 Exam was conducted by SEC examiner Bennett. Tr. 61; RX 50, RX 51. The fieldwork was conducted March 1, 2010 through March 12, 2010. Tr. 68; RX 50, RX 51. **During the 2010 Exam, Bennett spoke with Coty and she told him she did not think RJLC was engaged in performance advertising.**[25] Tr. 178-79. As discussed, *infra*, **if the SEC examiners are not of one mind as to whether RJLC was engaged in performance advertising, how in the world could Respondents have been on notice as to the "requirement" the Division now asserts?**

During the fieldwork for the 2010 Exam, in response to a request for all marketing materials, the examiners received a copy of the PowerPoint presentation. Tr. 85; DX 1. During

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[24] The 2003 Exam Report was reviewed and approved by Coty, Assistant Regional Director Michael Levitt and Associate Regional Director Rosalind Tyson. RX 22, SEC-LA3937-1022.

[25] The Division did not call Coty as a witness to explain why the SEC determined in 2003 that RJLC was not engaged in performance advertising or why the SEC did not raise any concern regarding the '73 Illustration or the use of the term "back-test."

the 2010 Exam, Bennett was aware that the PowerPoint slides were used during seminars "held throughout the country several times a month."[26] Tr. 86. Bennett was also aware Lucia personally conducted the seminars. Tr. 86. Nonetheless, during the 2010 Exam, the examiners did not ask Lucia to explain any aspect of the BOM strategy or the BOM seminar presentation, including the slides at issue. Tr. 92-93, 1306, RX 54. During the fieldwork, Bennett did question Lucia as to a number of other issues, including his professional relationships with Ben Stein, Glenn Beck and Bill Handel; adviser compensation; private fund ownership and RJLC litigation, but he failed to make any inquiry of Lucia as to the slides the Division now claims warrant an end to his career. RX 54, SEC-LA3937-1019. The Division presented no evidence that had Bennett asked Lucia to narrate the slides as if he was speaking to seminar attendees or give any context to the slides, he would have refused to do so.[27]

During the fieldwork, Bennett had discussions with RJLC financial planning supervisor Richard Plum ("Plum") and Chief Compliance Officer Theresa Ochs ("Ochs") some of which are documented in Respondents' Exhibit 54. During the May 12, 2010 exit interview with Ochs and other RJLC officers and compliance personnel, Bennett did not identify any deficiency issues concerning REITs, or other pertinent advertising issues, including failure to deduct advisory fees or failure to reallocate the Illustrations. Tr. 97, 171-72. With respect to the discussion regarding the use of a 3% inflation rate and a potential books and records deficiency, Ochs and Bennett offered conflicting testimony. Tr. 97, 544-48. Bennett testified that he "mentioned" that he had recalculated the back-tests and substituted actual inflation and "the

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[26] From March 1, 2010 to December 17, 2010 (the date of the 2010 Exam deficiency letter), there were 30 BOM seminars held, including eight of which were in Southern California and therefore, easily accessible to the examiners. Bennett testified "I'm fairly certain that it would have been against policy to go to one of the seminars" but was unable to reference any such policy. Tr. 163-64. Apparently there is also no policy against concealing the existence of a Formal Order.

[27] At the time of the 2010 Exam, Bennett was aware that *Clover* requires an understanding of the context in which performance advertising is used. Tr. 149-151.

portfolio would go broke and that would be, you know -- you know, we would consider that a misleading advertisement." Tr. 97. Ochs testified that although 3% inflation was discussed during the fieldwork, it was not discussed during the exit exam. Tr. 546-548. Ochs also testified that the tone of the exit interview was significantly different than the positions taken in the December 17, 2010 deficiency letter. Tr. 655, RX 50, RX 51.[28]

As revealed by the Division immediately prior to the hearing, a 2010 Exam Report was prepared, reviewed, approved and executed by Bennett, the Branch Chief, the Assistant Regional Director, and Martin Murphy ("Murphy") the Associate Regional Director of the Pacific Regional Office on November 8, 2010 ("November 2010 Exam Report"). RX 50, LA-SEC3937-005780. The November 2010 Exam Report does not conclude that a referral to the Division of Enforcement is warranted. *Id.* Bennett testified that his supervisor, Los Angeles Office Branch Chief John Kreimeyer, was of the "opinion that because there was no direct evidence of money being misappropriated," Enforcement would not be interested. Tr. 241. During the hearing, Bennett testified that the 2010 examiners found **no evidence that any investor money had been misappropriated and no evidence that any investor account had been mishandled.** Tr. 241.

The November 2010 Exam Report does **not** include a finding that RJLC violated Section 206(1) or 206(2). RX 50. The November 2010 Exam Report does **not** conclude, as the OIP does, that the purported "back-tests" were misleading as a result of REIT rates of return or failure to reallocate. RX 50, RX 51. While the Division has represented that the November 2010 Exam Report is a "draft," the fact that it is executed, dated and makes no reference to it being a "draft" makes the Division's representation suspect, at best. Respondents assert that the November 2010

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[28] Ochs' testimony concerning the tone of the exit interview and the lack of communication that there were any deficiencies that would support an enforcement proceeding, or that would not be resolved in responding to the Staff's deficiency letter is consistent with the fact that the SEC's Los Angeles Office drafted, reviewed and approved two versions of the 2010 Exam Report. RX 50, RX 51.

Exam Report is not a draft, but instead, demonstrates that the SEC determined that the deficiencies should be resolved through a deficiency letter and not an enforcement action.

Five weeks later, on December 16, 2010, a second 2010 Examination Report was prepared, reviewed, approved and executed by the same individuals from the Pacific Regional Office, including Murphy. ("December 2010 Exam Report"). RX 51, LA-SEC3937-005801-5823). Unlike the November 2010 Exam Report, the December 2010 Exam Report refers RJLC and RJLWM to Enforcement, inserts violations of Section 206(1) and 206(2) and introduces new bases for Enforcement to pursue - REIT rates of return and failure to reallocate. Bennett testified that the decision to refer the matter to Enforcement was made by Murphy when he reviewed the November 2010 Report. Tr. 184. However, this testimony begs the question, if so, why did Murphy sign and date the November 2010 Exam Report without an Enforcement referral? Moreover, the revisions to the December 2010 Exam Report lend substantial weight to the credibility of Ochs' version of the exit interview; namely that there was no indication or communication that the slides were misleading. Tr. 545-548.[29]

By deficiency letter dated December 17, 2010, over ten months following the 2010 Exam, the Staff communicated to RJLC the purported weaknesses and deficiencies identified by the examiners. RX 6. Upon receipt of the December 17, 2010, deficiency letter, notwithstanding the fact that Respondents disagreed with the Staff's conclusion that the slides were performance advertising and misleading, Respondents took immediate action which included: 1) reviewing all marketing materials, including the website and the BOM seminar presentation materials, and removing all references to the terms "back tested" and "time tested;" 2) removing from the BOM

[29] If the Staff had reached the conclusion during the 2010 Exam that an Enforcement referral was warranted and potential investors were being misled by the thousands at BOM seminars, it is revealing from a penalty perspective that the Staff allowed Lucia to continue presenting the slides at seminars for ten months before demanding that RJLC "cease disseminating misleading performance information."

seminar PowerPoint the '73 and '66 Illustration slides; and 3) ceasing distribution of the books authored by Lucia. Tr. 689-691, 1277, 1633.

By letters dated February 1 and 14, 2011, RJLC responded in detail to each of the issues raised in the December 17, 2010 deficiency letter. RX 7, RX 8. By letter dated March 17, 2011, the Staff responded to RJLC's February 1 and 14, 2011 letters, with a conclusory assertion that it disagreed with RJLC's factual positions, and requested materials related to a seminar held February 26, 2011 in Houston, Texas. RX 9. By letter dated April 14, 2011, Respondents responded to the March 17, 2011 letter and provided the documents requested. RX 10.

By subpoena dated May 11, 2011 in *In the Matter of RJL Companies, Inc.* (LA-3937), the Division demanded the production of certain documents from RJLC. RX 11. In response, RJLC requested a copy of the formal order of investigation. RX 12. Upon receipt of the formal order dated December 2, 2010 ("Formal Order"), RJLC became aware, for the first time, that the Formal Order had been issued prior to the December 17, 2010 deficiency letter and demand for written responses and documents.[30] RX 12.

Accordingly, while Respondents were producing documents, responding to inquiries, taking corrective action and engaging in an on-going good faith attempt to resolve the issues set forth in the December 17, 2010 deficiency letter, the Division was using the deficiency letters as a stalking horse to obtain documents and discovery which should have been requested in accordance with the Formal Order Process.[31] In their December 17, 2010 deficiency letter and follow on correspondence, the Staff repeatedly requested that Respondents furnish documentary

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[30] Again, from a penalty perspective, it is informative that as of the date the Formal Order was issued, neither the Staff nor the Division had requested or demanded that Lucia cease using the slides at the BOM seminars. This conduct speaks volumes as to what the Division really thought about the egregiousness of Respondents' conduct. If the SEC was concerned that potential investors were being misled, one would assume there would have been an immediate cease and desist demand.

[31] See Rule 7(a) of the SEC's Rules Relating to Investigations (Rights of Witnesses).

evidence and provide written responses to matters that are now the subject of this proceeding and encompassed within the Formal Order. By doing so, the Staff violated the Respondents' due process rights. Rule 7(a) of the SEC's Rules Relating to Investigations provides that any person who is compelled or required to furnish documents or testimony at a formal investigative proceeding shall, upon request, be shown the formal order of investigation. Respondents were precluded from requesting a copy of the Formal Order prior to producing documents and written responses to demands because the Staff concealed its existence from Respondents.[32]

III. LEGAL ARGUMENT

A. The Division Has Failed To Establish A Violation Of Section 206(1), 206(2), Or 206(4) Of The Advisers Act.

Sections 206(1), 206(2), and 206(4) of the Advisers Act, 15 U.S.C. § 80-b-6, provide in pertinent part:

> It shall be unlawful for any investment adviser by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—
>
> > (1) to employ any device, scheme, or artifice to defraud any client or prospective client;
> > (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;
> > (4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.

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[32] Had the Staff sought the information it demanded from Respondents through subpoenas and recorded testimony, as the issuance of a formal order presumes, Respondents would have been afforded the due process procedural mechanisms provided in the investigative process, including being advised of significant constitutional rights. *See SEC v. Wheeling-Pittsburgh Steel Corp.*, 648 F.2d 118, 127 (3rd Cir. 1981). Instead, the Staff demanded that Respondents produce documents and evidence without advising them of certain rights, including due process rights, attached to the demands. The Staff's actions knowingly misled Respondents about the purpose of the deficiency letters and information requests. *See SEC v. ESM Gov't Sec., Inc.*, 645 F.2d 310 (5th Cir. 1981); *SEC v. Cuban*, 798 F. Supp.2d 783 (N.D. Tex. 2011).

Rule 206(4)-1 is the principal rule by which the Commission regulates advertisements under the Advisers Act. Rule 206(4)-1 contains four specific prohibitions and one catchall provisions. 17 CFR § 275.206(4)-1. Specifically, Rule 206(4)-1(a)(5) makes it a violation of Section 206(4) for an investment adviser to publish, circulate, or distribute any advertisement which contains any untrue statement of material fact or which is otherwise false or misleading.

To establish that RJLC violated Section 206(1) of the Investment Advisers Act, the Division must prove that (1) RJLC was an investment adviser; (2) RJLC utilized the mails or instrumentalities of interstate commerce to employ a device, scheme or artifice; (3) the device, scheme or artifice violated RJLC's fiduciary duty to its clients or prospective clients in that it made false and misleading statements to its clients or prospective clients; and (4) RJLC acted with scienter. *Morris v. Wachovia Sec., Inc.*, 277 F. Supp.2d 622, 644 (E.D. Va. 2003).[33] The same elements apply for Section 206(2), except that no scienter is required. The Division must prove that the investment adviser failed to disclose a material fact. *Morris, supra,* at 644. *See also, SEC v. Merrill Scott & Assoc., Ltd.*, 505 F. Supp. 2d 1193 (D. Utah 2007); *In the Matter of Pelosi*, Initial Decision Release No. 448 (Jan. 5, 2012). The Division has the burden of proof of each claim and must prove each element by a preponderance of the evidence. *Steadman v. SEC*, 450 U.S. 91, 96 (1981).

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[33] Scienter is required to establish violations of Section 206(1) of the Advisers Act. *SEC v. Steadman*, 967 F.2d 636, 641 & n.3 (D.C. Cir. 1992). It is "a mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976); see also *Aaron v. SEC*, 446 U.S. 680, 686 n.5, 695-97 (1980); *SEC v. Steadman*, 967 F.2d at 641. Recklessness can satisfy the scienter requirement. *See David Disner*, 52 S.E.C. 1217, 1222 & n.20 (1997); *see also SEC v. Steadman, supra*, 967 F.2d at 641-42; *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1568-69 (9th Cir. 1990). Reckless conduct is conduct which is "'highly unreasonable' and . . . represents 'an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.'" *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 47 (2d Cir. 1978).

1. As Acknowledged By The SEC's 2003 Examiners, RJLC Is Not Engaged In Performance Advertising.

Because Rule 206(4)-1(a)(5) does not expressly prohibit performance advertising, the Division has attempted to regulate performance advertising under the catchall provision through a series of interpretative letters beginning with the oft-cited *Clover, supra*. Tr. 63. Division witness and SEC examiner Bennett testified that he was not aware of any guidance issued by the SEC concerning performance advertising, and is not aware of any judicial opinions describing what is permissible in terms of performance advertising by advisers. Tr. 145. *Clover*, which is entirely distinguishable from the facts here, addresses a situation where a registered investment adviser advertised investment results derived from a "model" portfolio. Importantly, in *Clover*, the "Model Portfolio" purchased and sold **specific identified securities which mirrored the securities purchased and sold in actual client accounts.**[34]

Here, the '73 and '66 Illustrations do not specify a type of bond, any particular stock, an identifiable REIT or real estate investment, or an institution's certificate of deposit – all particulars required to make these Illustrations fit within the performance advertising category. Indeed, both Illustrations include the S&P 500, an index, which, as disclosed to seminar attendees, is not something that can even be purchased by investors. No reasonable investor could have walked away from the BOM seminars believing he or she had just reviewed a model

[34] In *Clover*, the registrant advised the SEC's Division of Investment Management, "We feel it is important that prospective clients see how the investment returns presented to them were achieved. Use of the Model Portfolio allows people to see **what stocks we hold and what the recent transaction activity in the account has been.**" In comparison, the evidence concerning the BOM presentation and RJLC client plans conclusively demonstrates there was no model portfolio as each BOM plan was unique and custom tailored to the clients' goals and income needs. Tr. 571, 682, 730, 878, 883, 1282.

portfolio. More importantly, **no investor could have walked away from BOM seminar having made a decision, or even influenced as to a decision, to invest in any security.**[35]

In *Clover*, the Staff set forth a list of advertising practices it believed were inappropriate with respect to advertising model and actual results. However, neither *Clover* nor any other reported decision, no-action letter or offer of settlement addressing "model" or performance advertising has ever applied the Staff's interpretation to advertising related solely to an investment withdrawal strategy that does not identify any specific security, buy/sell recommendation, portfolio, account or asset that a potential purchaser could actually purchase. As the unrebutted testimony of Lucia established, even if a seminar attendee wanted to replicate the BOM strategy and "model" the "investments" in the illustrations, he or she would not be able to do so. Tr. 1284; see also Tr. 176, 1340, 1540, 1597. As such, the slides that the Division complains of are not advertising "model" performance and *Clover* is inapplicable.

Moreover, *Clover* is not the law. As Administrative Law Judge Kelly observed in *In the Matter of FXC Investors Corp. et al.*, Initial Decision Release No. 218 (December 9, 2002), 2002 WL 31741561, *10, apart from two cases there is an absence of "genuine precedent on the subject of performance advertising by investment advisers." Those cases, decided over a decade after *Clover*, do not mention, let alone validate, the Division's views in *Clover*. See, *Valicenti v. SEC*, 198 F.3d 62, 63 (2d Cir. 1999); *In re Seaboard Investment Advisers, Inc.*, Initial Release No. 149 (Sept. 21, 1999) 1999 WL 735233. The *FXC Investors* court recognized that, as has happened here, the Division "attempts to fill the void by citing to settled cases[] [and] staff no-action and interpretive letters . . . ." *Id.* "This 'precedent' is of limited value here." *Id.*

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[35] The unrebutted evidence is that no attendee ever requested that their BOM plan replicate the '73 or '66 Illustration. Tr. 1558-59, 1631-32.

"In the absence of an opinion stating the Commission's views on the issues raised, settlement[] [orders] are of dubious value as precedent. Settlements involving so-called 'speaking orders' are particularly suspect." *Id.* (citation omitted) Similarly, courts "will not accord great deference" to no action letters that "did not go through notice and comment." *N.Y. City Employees' Ret. Sys. v. SEC*, 45 F.3d 7, 14. **"Staff interpretations contained in opinion letters do not warrant judicial deference, are not binding on the courts, and have no value beyond their own persuasive weight."** *FXC Investors*, 2002 WL 31741561 at *11 (internal citations omitted)(emphasis added).[36]

Further, even if *Clover* were applicable to the BOM seminar slideshow, the 2010 examiners and the Division intentionally disregard *Clover's* mandate to consider the "total context" of the advertisement. *Clover, supra,* at fn. 3. Throughout the 2010 Exam, investigation and hearing, the examiners and the Division intentionally refused to acknowledge that the slideshow was a back drop for Lucia's oral presentation and other aspects of the BOM seminars. Bennett had ample opportunity between February and December of 2010 to attend a BOM seminar and declined to do so. Tr. 148. Bennett never asked Lucia what information he conveyed to seminar attendees. Tr. 1223. Incredibly, when the Webinar of the BOM presentation was produced, well in advance of the hearing, the Division declined to provide it to its expert, and strenuously objected to it being admitted into evidence. Tr. 963. Unquestionably,

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[36] This is because "staff no-action and interpretive letters are not expressions of the Commission's views and do not have the force of law. As the Commission itself has noted, no action and interpretive responses by the Staff are subject to reconsideration and should not be regarded as precedents binding on the Commission." *Id.*; *N.Y. City Employees' Ret. Sys., supra*, 45 F.3d at 12-13 (2d Cir. 1995) (no-action letters do not amount to an official statement of the SEC's views); *Public Availability of Requests for No Action and Interpretative Letters and Responses Thereto by the Commission's Staff*, Release No. 5098 (Oct. 29, 1970). Accordingly, "rules announced in no-action letters also have no binding authority." *N.Y. City Employees' Ret. Sys.*, 45 F.3d at 14. Importantly, "[e]ven when the federal courts rule in accord with no-action letters, they almost always analyze the issues independently of the letters." *FXC Investors*, 2002 WL 31741561 at *11; *N.Y. City Employees' Ret. Sys.*, 45 F.3d at 13.

the Webinar is the best evidence of whether the slideshow was misleading advertising. Tr. 879-880. Instead of welcoming the opportunity to consider the slideshow in it total context, as *Clover* dictates, the Division urged this Court to put blinders on and ignore the statements made to seminar attendees, the same group of potential investors the Division asserts were misled. As discussed, *infra*, the Webinar conclusively demonstrates that the '73 and '66 Illustrations are not back-tests or advertising model results. By its own terms, *Clover* is only applicable to advertisements that portray the actual or model performance of an actual or model portfolio. Therefore, it is inapplicable here because the '73 and '66 Illustrations do not purport to relate to the performance of any actual or model portfolio.

2. The BOM Strategy Is Not A Model Portfolio.

The BOM strategy is a retirement asset withdrawal strategy, not a formulaic model. Here, there was no representation of any actual trading or any purported performance by any client account or in any specific investment. Nor could there have been as the asset-types for each bucket are too general, i.e. direct ownership in real estate or REITs, stocks, T-Bills, etc. The Division's error in classifying the BOM strategy as a mechanical formula rather than an investment withdrawal philosophy may be best evidenced by the fact that the Staff previously reviewed the identical '73 Illustration during the 2003 Exam and raised no alarms - or mention - regarding its potential to mislead investors. It stands to reason that had the 2003 Staff considered the '73 Illustration a "back-test," as that term is now defined by the Division, of a model portfolio, they would have attempted to constrain its use under *Clover* or at least requested that Lucia cease using the slides. The '73 Illustration calculations have not changed from 2003; the 2003 slide is titled "Back Tested Buckets," assumes the same 3% inflation rate and REIT distribution rate, does not deduct advisory fees, and does not reallocate assets. RX 3, SEC-

LA3937-00161-170, 199-201; RX 30, 37:23-47:00; DX 40:20-42:23, 46:14-47:14. Yet from the 2003 Exam to the 2010 Exam, the '73 Illustration has gone from not worthy of mention to the focal point of an enforcement action which has decimated Respondents' business. What is clear is that from one examination to the next, the Staff from the same SEC office came to two completely opposite conclusions as to whether the '73 Illustrations are a "back-test" of a model portfolio and whether RJLC was engaged in performance advertising in violation of securities laws.[37] At a minimum, this demonstrates an absence of guidance by the SEC and a current effort by the Division to engage in rule-making via a proceeding against Respondents, in clear violation of their due process rights.

3. The BOM Seminar Slideshow Illustrations Are Not "Back-Tests" As That Term Is Now Defined By The Division.

Beginning with Bennett's inquiries during fieldwork for the 2010 Exam regarding the calculations for the Illustrations, RJLC has consistently taken the position that the '73 and '66 Illustrations were not "back-tests" as that term is now defined by the SEC and its expert. Tr. 899-902, RX 54. That the Illustrations are not "back-tests" is the one issue upon which the parties agree. Tr. 836-837, 1092; 1269; 1421; 1541-42; RX 35, DX 70. As Lucia testified, "there's just an enormous disconnect between my interpretation of what a 'back-test' was and the Division's interpretation of what a back-test was." Tr. 1269. As discussed, *infra*, in addition to Lucia and

[37] Although of limited, if any, precedential value, settlement orders for violations of model performance advertising further demonstrate that actions historically brought by the Division are limited to advertising relating to specific fund or client account performance. See *In re Patricia Owen-Michael*, Advisers Act Release No. 1584 (September 27, 1996); *In Re LBS Capital Management, Inc.*, Advisers Act Release No. 1644 (July 18, 1977); *In re Shield Management Co.*, Advisers Act Release No. 1871 (May 31, 2000); *In re Market Timing Systems, Inc. et al.*, Advisers Act Release No. 2047 (August 28, 2002). In *Owen-Michael*, the advertisement compared investments in specific mutual funds selected by the adviser to the S&P; in *LBS*, the advertisement identified specific equity mutual funds to advertise model market timing services; in *Schield* and *Market Timing*, the advisers failed to disclose that actual performance of client accounts was materially less than the models' hypothetical results for the period.

RJLC's compliance department, the compliance departments of RJLC's supervising broker dealers, First Allied Securities and Securities America, and the SEC's 2003 Exam team apparently share Lucia's opinion that there is a disconnect between the industry accepted definition of back-test and the definition the Division asserts controls here, particularly given that each reviewed the slides labeled "back-test" and expressed no concern. Tr. 1304-05.

To be sure, with the benefit of hindsight, Respondents would not have used the term "back-test" on two of the 127 PowerPoint slides, but there is ample evidence that any seminar attendee who saw the slides in the context of Lucia's oral presentation was aware that it was not a "back test" as defined by the Division. For example, Bennett knew the Illustrations were not "back-tests" as soon as he saw the use of an assumed a 3% inflation rate." Tr. 115-16. Similarly, the Division's expert testified that it was "obvious" to him that the Illustrations were not back-tests. Tr. 960.

Investor and Division witness Richard Desipio ("Desipio") testified that the Illustrations used . . ."an acceptable [inflation] rate. So maybe three percent, three or four percent, whatever that was." Tr. 286. Desipio clearly understood a reasonable rate was being plugged in as an assumption instead of an annual actual inflation rate. The bottom line is –a potential investor sophisticated enough to be familiar with the SEC's definition of back-test would immediately know the '73 and '66 Illustrations were not back-tests because assumed inflation and REIT rates of return were used. On the other hand – a potential investor not familiar with the SEC's definition of "back-test" would understand the disclosure language stating that the Illustrations were "hypotheticals" using "assumed" inflation and REIT rates to mean that indeed, the Illustrations were hypotheticals.[38] Therefore, no investor was misled.

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[38] The PowerPoint uses the term "hypothetical" 37 times and the term "back-test" twice.

Further, Bennett testified that during the 2010 Exam fieldwork, when asked about the inflation rate, Plum told him that the slideshow illustrations were supposed to be a "forward-looking exercise." Tr. 91, 900.[39] Respondents' Exhibit 54 which is a compilation of notes of interviews Bennett conducted with individuals from RJLC during the 2010 Exam memorializes a conversation Bennett had with Plum on March 12, 2010. The interview notes reflect that Bennett asked Plum to explain why the "back-testing for [the '73 Illustration] doesn't appear to match the spreadsheet we were given." RX 54, SEC-LA3937-1021, Tr. 91, 203. Plum responds "This is a hypothetical, not on a spreadsheet. This is designed more of a **prospective basis**, using today's . . ." Tr. 900-903, RX 54 (emphasis added.). Respondents' Exhibit 54 demonstrates that since March 2010, the first time the SEC questioned RJLC concerning the seminar slides, RJLC has consistently described the Illustrations as hypotheticals.

Finally, the best evidence that investors were not misled into believing the '73 or '66 Illustrations were using actual historical data for inflation and REIT returns is the Webinar presentation which conclusively demonstrates that the attendees were specifically told these Illustrations were not utilizing the actual higher inflation rate from the period. Tr. 777, 1547, 1686, RX 30, 48:10, DX 66, 48:21-49:2. During the Webinar presentation, when explaining the '66 Illustration, Lucia states, "**Let's pretend you had a million dollars. Let's also pretend you wanted 50,000 dollars per year, a reasonable five percent distribution. And let's pretend that from that point forward inflation was 3 percent. We know it was more, but we wouldn't have known that at the time.**" Tr. 777, 1547, 1686, RX 30, 48:10, DX 66, 48:21-49:2. The Webinar demonstrates that Lucia was simply comparing the efficacy of the BOM strategy to spend safe money before volatile money in comparison to the all equity and 60/40

[39] During the hearing, the Division attempted to elicit testimony to show that Respondents description of the '73 and '66 Illustrations as "forward looking back-tests" was a term fashioned in response to the OIP. Bennett's testimony belies that argument.

stock/bond pro rata withdrawal strategy when 1) there was a significant decline in the stock market and 2) when there was a prolonged period of market stagnation. Tr. 767-769, 777-80, 840, 1097-98; 1547; RX 3, SEC-LA3937-00161-170, 199-201, 202-211, RX 30, 37:23-47:00, 47:21-50:36; DX 66 40:20-42:23, 46:14-47:14, 47:15-51:19: see also, RX 51, LA-SEC3937-005812. **As Bennett acknowledged, a potential investor coming to RJLC to have a BOM plan created and implemented would be interested in what might happen from 2012 to 2030, not what happened between 1966 and 2003. Tr. 159.** There was no attempt to mislead any potential investor into believing actual historical inflation rates or REIT rates were being used, and no reasonable investor would believe his or her BOM plan would mirror the '73 or '66 Illustrations. Tr. 1558-59.[40]

While there are a very limited number of reported decisions addressing the bases for violations of Section 206(1) based on performance advertising, the cases that do discuss such violations make clear that to determine whether an advertisement is materially false or misleading, the facts and circumstances surrounding the advertisement should be considered. In *In the Matter of Valicenti Advisory Services, Inc.*, Initial Decision No. 111 (July, 2, 1997), the ALJ found "[w]hether any communication is, or is not, misleading **will depend on all the particular facts**, including (i) the **form as well as the content of a communication**; (ii) the **implications or inferences arising out of the communication in its total context**; and (iii) the sophistication of the prospe+ctive client." (emphasis added); *see also, Seaboard Investment Advisers, Inc., supra*, (evaluating factors indicating that respondents' conduct was not driven by desire to defraud or injure clients). To assert a violation based on the PowerPoint, without consideration of what the seminar attendees actually saw and heard is unprecedented and violates Respondents due process rights.

[40] The SEC acknowledged that it was not aware of Lucia ever promising a specific return. Tr 142.

While the Division hopes this Court will turn a blind eye to the content of the BOM seminar presentation, Lucia makes repeated disclosures that the Illustrations are hypotheticals and any attendee who heard Lucia's presentation would have understood the '73 and '66 Illustrations were not "back tests" using the Division's definition.

B. The Illustrations Do Not Contain An Untrue Statement Of Material Fact.

As acknowledged by the Division in its Pre-Hearing Brief, the standard for materiality under the Advisers Act is the same standard used under the antifraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934. The standard of materiality is whether or not a reasonable investor or prospective investor would have considered the information important in deciding whether or not to invest." *In the Matter of Brandt, Kelly & Simons LLC*, Initial Decision Release No. 289 (June 30, 2005) citing *SEC v. Steadman*, 967 F.2d 636, 643 (D.C. Cir. 1992), *see also*, *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988), *SEC v. Goble*, 682 F.3d 934 (11th Cir. 2012), *SEC v. Slocum*, 334 F. Supp. 2d 144 (D.R.I. 2004).

In *Basic, supra*, the Supreme Court adopted the standard set forth in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976) for materiality in the context of Rule 10b-5; "The role of the materiality requirement is to . . . filter out essentially useless information that a reasonable investor would not consider significant, even as part of a larger 'mix' of factors to consider in making his *investment decision*." *Basic, supra*, 485 U.S. at 234 (emphasis added). The BOM seminar attendees **were not being asked to make an "investment decision."** Tr. 572-73, 609, 1275, 1281. Instead, they decided whether to fill out a contact request to later meet with a RJLC advisor to have a BOM plan custom designed for them. Tr. 1072, 1281-82, 1559-60. Only after discussing the potential investor's income needs and goals and preparation of a unique BOM plan would any investments be proposed to the potential investor. Tr. 730-31, 1286, 1559-1563.

This process took place over an average of 207 days. Tr. 1285. Further, Respondents presented unrebutted evidence that each potential investor was fully advised of the risks related to each investment, and, importantly, the risks the OIP alleges were not disclosed on the '73 and '66 Illustrations, were disclosed when they met with an advisor. Tr. 141-42, 682, 1281, 1285-87, 1566-67.[41] This is not the situation contemplated by *Basic* or *TSC*.[42]

Indeed, *SEC v. Goble*, *supra*, the only Circuit case addressing whether the definition of materiality in the securities context includes the decision to invest with a particular investment firm held decisively in the negative. In *Goble*, which is on point and addresses analogous circumstances, the Eleventh Circuit found in the absence of a showing that a reasonable investor would have attached importance to the facts misrepresented or omitted when making an investment decision, a sham transaction by a brokerage firm was not material even if the facts misrepresented or omitted would have influenced a reasonable investor's choice of broker dealers. *Id.* at 944. In sum, the *Goble* court specifically declined to expand the definition of materiality to include a misrepresentation that would only influence an individuals' choice of broker dealers. *Id.* *Goble* is wholly applicable here where, at most, the Division seeks to prove that the purpose of the BOM seminar and the '73 and '66 Illustrations was to interest prospective investors to make an appointment with an RJLC advisor. Tr. 572-73, 1072-1073.

Contrary to every reported decision addressing the materiality standard, the Division's position is that an alleged misleading fact or omission made during a BOM seminar that does not relate to any identified security and where no investment products were even potentially

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[41] The SEC acknowledges that advisory fees and REIT risks and commissions were fully disclosed by RJLC to potential investors. Tr. 141-42, 212.

[42] *TSC* is specific to the omission of a material fact in the context of a proxy vote. In *Basic*, the Supreme Court recognized, "we face here the narrow question whether information concerning the existence and status of preliminary merger discussion is significant to the reasonable trader's investment decision." *Id.* at 235.

identified and discussed with the attendee until after his/her BOM plan was created and investment risks were disclosed, is material to an investment decision. This is not, and cannot be the law. As conclusively demonstrated, during the seminar presentations, Lucia does not promote or sell any specific stock, bond, mutual fund, annuity, real estate investment, or managed portfolio and does not make any promise or prediction as to the return on any investment portfolio. Tr. 142, 571, 572, 1274, 1281, 1284, 1594, 1597.[43]

Pursuant to the materiality standard articulated by the Supreme Court, in order to prove materiality, the Division must connect the alleged misleading fact or omission to an investment decision. The Division has failed to do so. Accordingly the alleged Section 206 violations should be dismissed.

C. **The Illustrations Do Not Make Misleading Statements To Prospective Clients.**

Based on Grenadier's analysis of the '66 Illustration, applying what he believes to be appropriate inflation rates, REIT rates of return and advisory fee deduction, an individual who retired in 1966 would need an annual income of $283,951 in the year 2003 when he was 103 years old. DX 70, Exh. 9a. Respondents submit that this calculation has no basis in reality and would materially mislead a potential investor.[44]

As demonstrated above, it simply was impossible for a potential RJLC investor to be misled by the '73 and '66 Illustrations. Even assuming a potential investor saw the Illustrations during a seminar and believed the inflation rate during the '73 or '66 time period was 3% and the REIT rate was 7%, and no fees would be deducted from his/her investments, an individual who

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[43] The Division presented no evidence that any BOM plan was misleading and admitted that it had made no allegations as to the BOM strategy. Tr. 25.

[44] As a point of reference, the Median Household Income for Retired Households for Retirees age 50 or older for 2001-2007 is $30,480. RX 35, Employee Benefit Research Institute, February 12, 2012, "Expenditure Patterns of Older Americans, 2001-2009" pg. 10 (attached as an exhibit Hekman's Report). Moreover, according to the U.S. Census Bureau, the median income of all families in 1966 was $7,400. http://www2.census.gov/prod2/popscan/p60-053.pdf

met with an adviser and got a personalized BOM plan would be disabused of any misleading information before he/she made any investment decision. The inflation rate each potential investor chooses for his/her RJLC BOM plan and its effect is disclosed and discussed, REIT rates and risks are discussed and disclosed in the prospectus each investor receives, advisory fees and transaction costs are discussed and disclosed, and reallocation is discussed throughout the client/RJLC advisor relationship. Tr. 1286, 1296, 1558-1562. In fact, during the process when the potential investor is deciding whether to invest and what products to purchase, weeks following the seminar, the '73 and '66 Illustrations play no part in that process. Tr. 1558-1562.

Importantly, prior to the filing of the OIP, the Respondents, the SEC and FINRA never received a single complaint from any seminar attendee that he or she was misled by or had suffered any monetary loss in connection with any representation made at a BOM seminar. Tr. 142, 671-672, 882, 1274-75, 1477-78, 1557. Given that Lucia has been presenting the BOM withdrawal strategy at seminars for approximately 20 years, one would expect that had any attendee felt misled by the BOM seminars or the Illustrations, complaints would have surfaced.

1. Respondents Use Of An Assumed 3% Inflation Rate Was Not Misleading.

Not surprisingly, given that there is no guidance by the SEC on this issue, the Division's position as to why the 3% inflation rate utilized in the '73 and '66 slides is misleading has shifted over the past two years. In the December 17, 2010 deficiency letter, the Staff asserted that the "actual average inflation rate for the period beginning January 1, 1966 and ending December 31, 2003 was 4.8%, but the back-tested portfolio assumed a constant inflation rate of 3%, without disclosing the actual inflation rate for the period or the effect of the actual inflation rates on portfolio performance." RX 6, SEC-LA3937-03646. This theory, that Respondents should have utilized an **average** historical inflation rate of 4.8% instead of 3%, comports with

the Division's position as articulated during the examination and investigation. Tr. 909-10, 965-966. Apparently as a result of Grenadier's opinion, and after Respondents made a Wells Submission responding to the alleged misleading inflation rate, the Division's position concerning the inflation rate Lucia should have used to make the '73 and '66 Illustrations not misleading – and a true "back-test" – has shifted significantly.

For the purposes of the OIP, the Division radically changed its position as to the inflation rate necessary to be utilized in order for a "back-test" not to be misleading. Now the Division and its expert assert that Respondents misled investors by failing to apply the actual annual inflation rate for each year of the '73 and '66 Illustrations. This revised view, i.e. that averages are misleading, is a position that has never been articulated by the Commission and would subject virtually every adviser that has advertised historical performance data to be in violation of Section 206.[45] Moreover, the inconsistency among the Staff, the Division and the Division's expert as to the appropriate inflation rate underscores that a reasonable (not misleading) historical rate of inflation is open to interpretation.

Use of an assumed 3% inflation rate in the '73 and '66 Illustrations does not violate Section 206. First, during the seminar presentation, when explaining the hypotheticals, Lucia expressly tells the attendees, "**And let's pretend that from that point [1966] forward inflation was 3 percent. We know it was more, but we wouldn't have known that at the time.**" Tr. 1340, 1556-57, RX 30 at 48:10, DX 66, 48:21-49:2, see also, RX 30 at 46:08, DX 60 46:14-47:14. This statement conclusively demonstrates that Lucia specifically advised the attendees that the inflation rate during the 1966 to 2003 time period was higher than 3%, but he was using 3% consistent with the other withdrawal scenarios describing the '73 market decline. *Id.* Tr. 777,

[45] For example, American Funds, a trillion plus dollar "mutual fund house" currently has an article on the Internet which charts "Back-testing withdrawal rates on indexes" from 1961-2010 and utilizes a 4% average inflation rate for that time period. Tr. 973, RX 46.

870, 1340, RX 3, SEC-LA3937-00161-170, 199-201, 202-211, RX 30, 37:23-47:00, 47:21-50:36; DX 66 40:20-42:23, 46:14-47:14, 47:15-51:19.[46] This statement absolves Respondents from a finding of scienter regarding the use of a 3% inflation rate.

The Division's propensity deceptively to present Lucia's statements concerning the 3% inflation rate is best exemplified by the decision to misquote Lucia's book, *Ready, Set, Retire* in the OIP allegations. OIP ¶ 8. In quoting Lucia's description of the '66 – 2003 hypothetical he discussed with Ben Stein,[47] the Division conveniently omits that Lucia actually writes, "**Figuring 3% inflation.**" OIP ¶ 8, RX 32, p. 57, see also Tr. 1115. Of course, this statement was omitted because it is additional, compelling evidence that Lucia consistently made it clear that the 3% inflation rate was an assumed, **forward-looking**, reasonable rate, and did not mislead potential investors through books or seminars. The Division's decision purposefully to misrepresent the text of Lucia's books in the OIP is troubling.

Second, given that Lucia specifically disclosed to the seminar attendees that a 3% **assumed** inflation was being utilized in all the illustrations, including the '73 and '66 Illustrations, the issue becomes whether a 3% assumed inflation rate is misleading. It is not. Respondents' expert, John Hekman, Ph.D. ("Hekman") an economist and a Managing Director at FTI Consulting, testified that the use of a 3% inflation rate for retirement planning calculations is universally recognized. Tr. 1401, RX 35. The Division's expert concurred. Tr. 794-795, 880, see also Tr. 1289. The Consumer Price Index for Urban Consumers ("CPI-U") which is measured by the Bureau of Labor Statistics ("BLS") reflects an average rate of inflation from 1913 to 2010 of 3%. Tr. 964. Indeed, the retirement calculator for the United States Office of Personnel Management utilizes a 3% inflation rate for SEC employees retirement planning. RX 42. This is

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[46] No seminar attendee ever complained to Respondents that the BOM seminar illustrations did not use an appropriate inflation rate. Tr. 882, 1557.

[47] This hypothetical is the same as the '66 Illustration.

relevant because during the seminars, Lucia makes clear that in discussing the 1973 and 1966 Illustrations, he is using a **forward looking** inflation rate. RX 30 at 48:10, DX 66, 48:21-49:2. Hekman opined that given the statements by Lucia during the Webinar describing the '73 and '66 Illustrations as forward looking, 3% was a reasonable inflation rate to use in the those illustrations. Tr. 1401, RX 35, p. 14.[48]

Third, while the actual historical rate of inflation is disputed among economists and academic scholars, economists agree that the CPI-U is overstated.[49] Tr. 1405, 1410, RX 35, p. 8-9. The highly regarded Boskin Commission Report published in 1996 recommended downward adjustments in the CPI of an average 1.1% per annum. Tr. 1000, RX 39, 40.[50] Most of the Boskin Commission recommendations were implemented by the BLS.[51] Hekman's Report concludes that it is reasonable to take into account the 1.2% bias from the Boskin Commission and subsequent study as well as an additional 2% inflation downward adjustment as indicated by an applicable Employee Benefits Research Institute Report which demonstrates that spending

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[48] Hekman opined that a reasonable investor would have understood the Illustrations were not "back-tests" and testified that it was clear when reviewing the slides in conjunction with the Webinar **"that the idea was to talk to people about looking forward and what to expect in terms of the ability of their assets to last through their retirement and that the examples of 1966 and 1973 were saying what if the markets performed as badly as they did over those periods and assuming a reasonable 3 percent inflation rate."** Tr. 1401-1402, RX 35, p. 14.

[49] The CPI-U has a substantial effect on the amount of social security payments and therefore is a major political issue. Indeed, there has recently been widespread news coverage that Congress and the President considered replacing the CPI with the arguably more accurate "Chained CPI," which would lower the estimated inflation rate by 0.25 to 0.33 percent during the "fiscal cliff" negotiations. http://www.cbsnews.com/8301-505146_162-57560374/chaining-inflation-gauge-would-hurt-social-security-recipients/.

[50] The Boskin Commission concluded "Changes in the CPI have substantially overstated the **actual rate of price inflation**, by about 1.3 percentage points per annum prior to 1996. . . .It is likely that a large bias also occurred looking back over at least the last couple of decades." RX 39 (emphasis added).

[51] A subsequent 2006 study published by the National Bureau of Economic Research and authored by Boskin Commission member Robert Gordon, concludes that in retrospect, the Boskin Commission should have recommended a 1.2 to 1.3 percent downward adjustment to the CPI. RX 40. In addition, in 2002, the BLS began publishing a consumer price index called the Chained Consumer Price Index for All Urban Consumers, designated the C-CPI-U, which is designed to be a closer approximation to a "cost of living" index than existing BLS measures. Further, a March 2010 Report published by the BLS found that average annual expenditures dropped substantially during retirement years. RX 43.

declines 2% per year after age 65. Tr. 1419, RX 35, fn. 20. Indeed, one of the articles relied upon by Grenadier states,

> Many economists believe, however, that inflation as measured by the CPI overstates the actual increase in cost of living by 1.0 to 1.5 percentage points per year. . . . Planning for CPI-adjusted withdrawals places great demands on the portfolio and requires the investor to reduce the withdrawal rate, perhaps more than necessary. As a result, the investor may forego more current consumption for future consumption that is necessary to maintain a given standard of living.[52]

In addition to the CPI-U historical inflation rates, Grenadier's Report also posits that Respondents should have calculated the "back-test" using the CPI-E (Experimental), notwithstanding the fact that the Division offered no evidence that this is an accepted or standard calculation in the industry. DX 70, SEC EX009-010, 035-36. Respondents assert that application of the CPI-E inflation rates in retirement withdrawal strategies would be highly misleading. For example, the CPI-E attributes 47% of retiree spending to housing costs irrespective of the fact that a majority of retirees own their homes free and clear and therefore the inflation for housing for those retirees would be *de minimus*. Tr. 1175-78, 1413, 1545-47. The CPI-E treats all retirees as renters, regardless of whether they own their homes, which results in a significant upwards bias in the inflation rate. Tr. 1413-14, 1545-47, RX 35, p. 9-10.

Given Respondents' decades long experience with financial planning for retirees, they understand that a retiree's increase in spending and associated increase in retirement income distributions is generally less than the actual inflation rate. Tr. 795-799, 867, 1195-96.[53] Plum testified that in his experience retirees have lower rates of inflation than the CPI suggests and he

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[52] Cooley, Philip L., et al., "Retirement Savings: Choosing a Withdrawal Rate That Is Sustainable" *AAII Journal*, February 1998, pp 19-20. See, Grenadier Report DX 70, P. 6.

[53] The Division presented no evidence that Grenadier had any experience with retirement planning.

and RJLC advisor Janean Stripe ("Stripe")[54] have never had a client request that his/her distributions be increased by the previous year's inflation rate. Tr. 867, 1562, see also, 1196.

Finally, the purpose of the Illustrations, which is clear from the Webinar, was to show that with identical returns on bonds, identical returns on stocks, identical inflation rate and identical distributions, changing one factor – taking income distributions from safe money instead of volatile money – makes a big difference. Tr. 779-780, 1154; RX 30. Therefore, the use of a particular inflation rate is irrelevant for purposes of the illustrations because the same inflation rate is applied to all of the compared strategies, thereby making any comparison apples to apples. Applying an inflation rate based on the average and yearly consumer price index would have only depleted an investor's funds more quickly across all strategies, but it would have had no effect on the ultimate message – the BOM strategy preserves funds longer than the compared strategies. Tr. 91, 122, 799-800, 816, 1154, 1403, RX 35, p. 8.

For the foregoing reasons, the use of a disclosed "assumed" 3% inflation rate in the '73 and '66 Illustrations was not misleading and does not violate Section 206 of the Advisers Act.

2. Respondents Use Of An Assumed REIT Dividend Rate Was Not Misleading.[55]

The OIP alleges it was misleading for Respondents to fail to disclose that the REIT rates of return in the Illustrations were "entirely" hypothetical and "failed to disclose that using an assumed REIT return materially inflated the results of the purported back-testing." As demonstrated, *infra*, the '73 and '66 Illustrations were not "back-tests" as that term is now defined by the SEC, but instead were hypotheticals. As such, by clearly disclosing the

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[54] Stripe has been affiliated with a Lucia related entity, including RJLC, since 1993. Tr. 1552. As a RJLWM advisor, Stripe currently has approximately 600 clients. Tr. 1557.

[55] Respondents were not given the opportunity to address the assumed REIT rate of return issue in their Wells Submission to the Commission because the Staff specifically advised counsel that an enforcement action would not include a purported violation based on assumed REIT rates of return.

assumptions of the Illustrations to the seminar attendees, Respondents did not mislead the attendees.[56] Moreover, as conclusively demonstrated at the hearing, the assumed REIT rates of return were conservative, reasonable and not misleading.

Respondents' REIT expert, Kevin Gannon ("Gannon"), the managing director, president and chief executive officer of Robert A. Stanger & Co. ("Stanger")[57] was engaged to summarize and review data available on REITs and other similar securities for the period 1966 to 2003. Tr. 1363, 1366, RX 34. Gannon opined that the use of a 7.0 % return for REITs for the period 1966 to 2003 and 7.75% for the period 1973 to 2003 is reasonable from a financial point of view, and supported by the NAREIT Index for the period 1972 to 2003 and other identified research. Tr. 1366-69, 1387, 1391-9, RX 34. Gannon relied on the FTSE NAREIT total equity real estate index ("NAREIT Equity Index") for the period 1972 to 2003 and built a model applying a number of conservative assumptions to determine a rate of return for the period 1966 to 1971.[58] Tr. 1367, R 34. Gannon's opinion is that a 7% for the period 1966 to 2003 is "extremely conservative." Tr. 1366-69, 1387, 1391-92.

Gannon utilized the NAREIT Equity Index as opposed to the NAREIT All REIT Index ("All REIT") because the All REIT Index includes investments outside the scope of real estate investments, including mortgage REITS, timber REITs and infrastructure REITs. Tr. 1374, RX 34. Additionally, Gannon was aware from his review of the BOM seminar PowerPoint that it utilizes the "FTSE NAREIT Equity REIT Index." Tr. 1374-75; RX 3, SEC-LA3937-00149.

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[56] Moreover, in the Webinar, Lucia states that the "assumed REIT rate of return" is "certainly not guaranteed." RX 30, 33:13, DX 66, 58:19-22.

[57] Gannon's valuation experience principally involves REITs, partnerships and partnership securities. Gannon and the staff of Stanger, under his direction, are responsible for the valuation of more than $50 billion of non-traded securities annually. RX 34, p. 9.

[58] Neither NAREIT nor any other party published an index relating to real estate investment trust securities prior to December 31, 1971. RX 34, p. 4.

Instead of using the NAREIT Equity Index referenced in the PowerPoint, Grenadier's calculations utilize the All REIT Index. DX 70, p. 11. As a basis for using the All REIT Index, which has a lower REIT rate of return than the NAREIT Equity Index, Grenadier states that the "spreadsheets do not make clear what type of REIT investment is assumed." Tr. 1376, DX 70, p. 11. However, the PowerPoint specifically references equity REITs and the NAREIT Equity Index, so Grenadier either missed this reference or his use of the All REIT Index was a calculated effort to present a more dramatic deviation from the calculations presented by Lucia.[59] Moreover, had Grenadier reviewed the Webinar, he would have seen and heard that Lucia specifically discusses the declining correlation of Equity REIT total returns to other types of investments. RX 30 33:20-34:25, DX 33:2-35:25. Gannon testified that he is not aware of anyone in the industry who references the All REIT Index in connection with equity REITs. Tr. 1376. Grenadier's qualifications, as listed in his *curriculum vita* do not state that he has any experience with equity REIT valuations or non-traded REIT valuations. DX 70, Appendix A.

During the BOM seminars, Lucia repeatedly advocates that investors invest in "direct ownership in real estate" as an asset class for diversification. RX 30, 33:13. During the Webinar, Lucia states, " . . . we really focus a lot on non-tradable *direct ownership in real estate*. Because real estate, as an asset class, has produced returns that are similar to stocks, but they get there a little different way," and " . . . I'll be referring to *direct ownership in real estate in the Buckets of Money strategy*, because it's not only a staple, it is critical in giving us stable income with not a lot of volatility . . . ." DX 66, 34:12-17; DX 66, 35:3-8. In discussing the '66 Illustration, Lucia states, "Let's assume we put forty percent in T-bills, twenty percent in *direct ownership in real estate* . . . ." DX 66, 50:3-5. (emphasis added.) It is important to note that without the benefit of

[59] Further, many of the assumptions he utilized for REIT calculations are antithetical to the BOM strategy. Tr. 1296.

attending a seminar or hearing Lucia's presentation, the SEC examiners, the Division and Grenadier had no way of knowing that the asset class used potentially to fill one of the buckets was the broad category of direct ownership in real estate, and not limited to REITs. Tr. 1565-67. While the slides shorthand direct ownership in real estate as "REITs", the seminar attendees were advised as to the breadth of this diversified asset class. DX 66, 34:12-17; DX 66, 35:3-8.

Because the '73 and '66 Illustrations do not identify a specific real estate investment, it would be impossible to apply an actual historical rate of return in the manner urged by the SEC's expert. Given the general description of the investment as "direct ownership in real estate" during the seminar, no reasonable investor would have inferred that Lucia was describing a specific REIT or that the assumed rate of return was based on a specific REIT investment. Once again, when the slides are viewed in totality and within the context of the oral presentation, which the slides are designed to supplement not supplant, there is nothing misleading about assumed REIT rates of return, why they are assumed, and what results when you apply the rate consistently across the varying withdrawal strategies.

Accordingly, the use of a disclosed "assumed" REIT rate of return in the Illustrations was not misleading and did not violate Section 206 of the Advisers Act.

3. Respondents Did Not Mislead Prospective Clients Concerning Advisory Fees.

The Division claims that it was materially misleading to fail to disclose to investors that the Illustrations do not deduct advisory fees.[60] To allege this claim, the Division goes through an

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[60] This requirement that performance information must be presented net of fees is entirely a Division construct under *Clover*. Thomas P. Lemke, Regulation of Investment Advisers § 2:75 (2012) ("prior to Clover it was generally understood that an advertisement would not be *per se* fraudulent if it included gross performance results and separately disclosed the range or amount of fees an investor would have incurred"). It is also a prime example of how the Division's views regarding performance advertising remain unsettled. In *Clover*, the Division took the uncompromising position that performance information must reflect the deduction of actual advisory fees. Ten years later, the Division reversed its position and stated that performance information could reflect a model fee if the result was no higher than

exceedingly tortured analysis. According to the OIP, certain spreadsheets ("Spreadsheets") prepared by Respondents did not include deductions for advisory fees, and because those Spreadsheets are alleged to have "tested" the 1973 and 1966 Illustrations, and because the Spreadsheet calculations do not deduct advisory fees, the Illustrations are misleading. OIP, §§ 23-25, DX 12, DX 13.[61]

The evidence conclusively demonstrates that Respondents did not violate Section 206 for failure to deduct advisory fees on the following grounds: First, the slides at issue relate only to the BOM withdrawal strategy and do not, for example, relate to any specific investments or allocations. Tr. 572-73, 1072, 1286, 1559. Deducting a model fee would have been impossible because the Illustrations did not describe investments sufficiently to assign a cost or a fee. Indeed, it would be impossible, and therefore misleading, to deduct a fee for an undefined real estate investment or T-Bill investment. Tr. 1284. Deducting a transaction cost for an investment in the S&P 500, an index which the slides specifically disclose cannot be purchased, would have been similarly misleading. Tr. 1284, RX 3, SEC-LA3937-00161-65, 168-69, 200. As Lucia testified, "our firm doesn't sell and can't sell indices such as the S&P and even if a person came and said I want to buy that strategy exactly as you presented it, if I charged them a fee to buy the strategy, I would be sitting here again because that's reverse churning."[62] Tr. 1284. Moreover, the American Funds back-tested portfolio which is also measured by an S&P 500 index and a corporate bond index and does not deduct advisory fees or transaction costs, provides unrebutted

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if actual fees had been deducted. *J.P. Morgan Investment Management, Inc.* (SEC No-Action Letter May 7, 1996).

[61] As discussed, *infra*, there is no authority for the Division's position that Rule 204(4)-2(a)(16) requires maintenance of books and records (the Spreadsheets) in connection with a comparison of withdrawal strategies where there is no performance calculation for any managed account or securities recommendation.

[62] Reverse churning is the practice of investing client assets in a portfolio that is not continuously managed and collecting a fee.

evidence of the industry standard concerning the deduction of advisory fees for hypotheticals using historical index rates of return. RX 46.[63]

Second, the slides specifically disclose that "there are fees and expenses associated with investing in mutual funds, including portfolio management fees and expenses and sales charges" and Lucia discusses fees at the seminars Tr. 408-09, 1199, 1285; RX 3, SEC-LA3937-00093. The seminar slides also urge attendees to "please consider the investment objectives, risks, **charges and expenses** carefully before investing." *Id.* As admitted by Bennett, there was nothing that precluded a seminar attendee from implementing his/her own BOM strategy without ever contacting RJLC or incurring any advisory fee. Tr. 157. Lucia, Jr. testified that prospective investors have also had BOM plans prepared – free of charge – and then implemented it themselves or with non-RJLC advisers without becoming RJLC clients. Tr. 1612-13.

Third, it would be impossible, and therefore misleading, to advise investors that a specific advisory fee or transaction cost would necessarily apply to the BOM strategy.[64] The BOM strategy is an asset withdrawal methodology which requires an individually customized portfolio dependent on a number of factors, including income need, assets, savings, time horizon, risk tolerance, tax bracket, investment mix, etc. Tr. 730-731. As RJLC advisor Stripe testified, "

> There's not an actual advisory fee charged per client. There is a portion of the plan that could be an actively managed part of the portfolio and if there is an actively managed part of the portfolio there could be advisory fees associated with that. But we have a range of strategies including buy and hold which would be transaction based fees including mutual funds they could purchase or unit investment trusts or we also have annuity options. So those ranges of options do

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63 See also, RX 37 and DX 80.

64 In its December 17, 2010 deficiency letter, the Staff asserts that they applied a 1% annual management fee to the 1966 through 2003 illustration, which resulted in a different outcome than Lucia's calculation. Application of a 1% annual management fee, which may have little or no relevance to an individual's implementation of the BOM strategy, would arguably be more misleading than not including advisory fees as an assumption. For example, fees and costs associated with the safer all CD – type strategy could have potentially been much lower than fees and costs for implementing the BOM strategy so that applying a 1% transaction fee actually could have been misleading.

> not have an advisory fee. It would only be on an actively managed part of the portfolio. Tr. 1564, see also Tr. 1663-67.

Stripe also testified that only approximately 25% of her 600 clients paid advisory fees to RJLC. Tr. 1563-64. As admitted by the SEC, in the event a seminar attendee later met with a RJLC adviser and became a RJLC client, all fees and transaction costs associated with the specific investments they chose were fully disclosed. Tr. 158, 682, 1285.

Finally, although the Division must desperately cling to the Spreadsheets to give the allegations an aura of validity, the fact is, no attendee ever saw the Spreadsheets,[65] and, because the Spreadsheets do not demonstrate the calculation of the performance or rate of return of any *managed accounts or securities recommendations*, the maintenance of such records is not required by Rule 204. Tr. 174-75, 860. The Division's attempt to use calculations such as those in the Spreadsheets as the basis for a Section 206 violation is unprecedented and without merit.[66]

4. Respondents Did Not Mislead Prospective Investors By Failing To Reallocate Assets in the '73 and '66 Illustrations.

Finally, the OIP alleges that Respondents misled potential investors because the Spreadsheets do not reallocate assets after the bond and REIT buckets are exhausted which results in overstating the performance of the BOM strategy and materially misleading the results that could be expected. OIP §§ 26-27. Like the REIT based allegations, this is a purported deficiency that was never communicated to RJLC during the 2003 Exam, the 2010 Exam, and was not mentioned in the November 2010 Exam Report. Tr. 97-98, RX 13, RX 22, RX 50. During the 2010 Exam, the SEC examiners never asked Lucia or anyone from RJLC to explain why the '73 and '66 Illustrations were not reallocated. Tr. 1305-06, RX 54 . Even the December

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[65] Moreover, Plum offered unrebutted testimony that Exhibit 13 was not created to support the calculations in the '73 Illustrations. Tr. 801 -02

[66] The Staff examined RJLC in 2003 and 2010 and did not find any deficiencies with respect to disclosure to clients of transaction fees and costs. RX 22, RX 51.

17, 2010 deficiency letter to Respondents acknowledges that reallocating assets from Bucket #3 to Buckets #1 or #2 is not mandatory, "[w]hen the investor depletes Bucket #1 assets, the investor then withdraws income from Bucket #2 until assets in Bucket #2 are depleted. At that point, the investor **could** reallocate assets from Bucket #3 to Bucket #1 and Bucket #2 and repeat the process." RX 6, SEC-LA3937-03645. This is yet another issue that could easily have been resolved if the SEC or the Division had made the effort to attend a BOM seminar, watched the Webinar or simply asked Lucia for an explanation.

Simply put, the seminar is a continuum of information regarding the BOM strategy and, while the order of the information may not be the Division's preference, the seminar attendees heard Lucia's explanation regarding rebalancing and were not misled. Importantly, at the point in the seminar when the '73 and '66 Illustrations are presented, Lucia has just begun to introduce the concept of the BOM withdrawal strategy and or reallocation. Immediately following the '66 Illustration, Lucia manually draws a sample BOM plan and discusses rebalancing at length. Tr. 877, RX 30, 53:24-1:10:45, DX 66, 53:2-69:5. As this is not on the PowerPoint, the attendees saw it, but the SEC and Division were likely unaware of this portion of the seminar. Regarding reallocation, in the Webinar, Lucia states:

> How do you rebalance your bucket? Well, you know, one of the things that I talk about in my book "Ready, Set, Retire" is something called value averaging.[67] You know, if you have a bucket of money, if you're going to look at your last bucket, the stock bucket, right -- and let's call that stock -- and you build in an expectation. So let's say you expect it to earn eight percent. And in a year where it earns, say, twelve percent, you're four percent over. So what you can do is you can take that four percent and rebucketize it in a different bucket, maybe sanitize that money in a safe environment, and have it sit there, so in a year, where the market goes down six percent, you can maybe take some of that money and dump it back into the stock market. So value averaging your last bucket, can be a good thing to do, because remember,

[67] See *Ready, Set, Retire,* RX 32, pg. 132-134.

> after the stock market goes down, ... there's usually a nice snap back. And when the market goes up twenty-eight percent, if all you expected was an eight percent return, well, you might take that extra twenty percent, dump it into a safe bucket, so that when the market comes down, you've got safe money that you can buy in. It's a little more sophisticated approach. Something I would work with, with your financial advisor. But talk to them about value averaging your last bucket of money, the stock market bucket of money. DX, 66, 80:10 -81:21, *see also*, Tr. 877, 1130-32, 1624-25.

Because each BOM plan is unique to the client, and not a managed account or fund, there is no singular point in time when it would have been the most – or least – advantageous to rebalance. At the seminars, Lucia explains to the attendees that in reality, an individuals' BOM plan would not, for example, be automatically reallocated in year ten. Instead, each client determines with his/or advisor, the strategic time to reallocate based on market conditions and client income needs. [68] Tr. 883-86, 1130-32, 1625.

Moreover, as shown, *supra*, the purpose of the '73 Illustration was to compare the BOM withdrawal strategy to the prior PowerPoint illustrations showing the effect of the '73 bear market on the 100% Stock Portfolio and the 60/40 Stock/Bond Portfolio, and to demonstrate that when "safe" money is withdrawn first, the BOM strategy income distributions last longer. Tr. 737, 767-769, 799, 840, 859, 1097-98; 1547; RX 3, SEC-LA3937-00161-170, 199-201; RX 30, 37:23-47:00; DX 40:20-42:23, 46:14-47:14, see also, RX 51, LA-SEC3937-005812. The strategies to which Lucia compares the BOM strategy, 100% Stock Portfolio and 60/40 Stock/Equity Portfolio, are also not rebalanced. Therefore, in order to maintain an "apples to apples" comparison, Lucia did not rebalance the '73 and '66 Illustrations. Tr. 1130-31. Respondents assert that choosing an arbitrary point in time to reallocate the BOM strategy

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[68] Selecting an arbitrary date to reallocate could easily have given the seminar attendees the false impression that they would be required to reallocate after a predetermined period of time. This is not consistent with the BOM strategy and could have mislead a seminar attendee into thinking all he/she had to do was simply set up their own BOM plan and mark their calendars for the reallocation date. Tr. 856.

without reallocating the 60/40 Stock/Bond Portfolio would have been confusing, and could potentially have been misleading.[69] Tr. 859-60.

D. RJLC Cannot Be Liable For A Violation Of Section 206(1) Because It Did Not Act With Scienter.

In order to establish scienter, the Division must prove that RJLC "acted with an intent to deceive, manipulate or defraud." *Moran, supra*, 922 F. Supp. at 896-97. This is a standard the Division has failed to prove. There has been no evidence presented that Lucia or anyone associated with RJLC was aware or should have been aware that the '73 or '66 Illustrations were misleading or that the Division would consider the Illustrations misleading.

1. No Complaints By Any Seminar Attendee That Slideshow Was Misleading

Bennett testified that of the "potentially tens of thousands of people who attended Lucia's seminar" he is aware of **no complaints to the SEC** that any seminar attendee was misled. Tr. 142. Lucia, Ochs, Dotson, and Stripe each testified that they never received a complaint from a seminar attendee concerning the PowerPoint or the Illustrations, and are aware of none. Tr. 671-2, 677, 1274, 1477-78, 1557.[70] Given the public's broad access to Lucia via his daily radio show which does not screen callers for content, **the lack of complaints is certainly not due to the lack of a forum.** Tr. 733, 884-85, 908-09, 1073. The Division presented no evidence that any seminar attendee has ever complained that the seminars were misleading.

After trolling for witnesses by contacting plaintiff attorneys who have created websites dedicated to soliciting investors to sue Respondents, the Division presented two investor witnesses, both of whom demonstrated significant credibility issues. Tr. 301-302. Investor

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[69] Respondents posit that it could potentially have been misleading if Lucia had manipulated the rebalancing date to a date with the most advantageous returns for the BOM strategy in comparison to the other strategies. Therefore, the only fair comparison was to not rebalance at all.

[70] In the 20 years Lucia has been presenting the BOM withdrawal strategy, no seminar attendee has ever complained to him that their BOM plan or the strategy didn't work. Tr. 1273-75.

witness Desipio, testified that he attended a BOM seminar in 2007 and saw the PowerPoint presentation. Tr. 247-249. Desipio had minimal recollection of the '73 or '66 Illustrations, other than the BOM strategy compared favorably to the other withdrawal strategies. Tr. 258, 262, 267, 286, 295. For example, Desipio did not recall anything being said about the use of a particular annual inflation rate in the calculation of the '66 Illustration, even after viewing the slides. Tr. 262, 267, 268, 295. Desipio was provided a BOM plan, but he did not implement the plan. Tr. 291-93. Instead, he purchased three REITs and a mortgage-backed security. Tr. 292. For credibility consideration, Desipio testified that he filed a FINRA action against Lucia regarding an investment in a mortgage backed security, IMH. Tr. 303, 305 Desipio's FINRA complaint makes a series of allegations concerning the lack of disclosures and risks for his investment in IMH. Tr. 313-318. Desipio admitted his FINRA complaint contains false allegations. Tr. 313-318. Desipio also admitted that his FINRA complaint against Lucia was false and that he released Lucia from the FINRA complaint. Tr. 319. Notably, although Desipio went to the effort to file a false FINRA claim against Lucia, his FINRA complaint contains no allegations that the BOM seminar, the PowerPoint or the Illustrations were misleading or that he was misled by the '73 or '66 Illustrations. Tr. 313.

Investor witness Dennis Chisholm ("Chisholm") initially testified that he had been to a BOM seminar in early 2010. Tr. 337. Chisholm testified that he had listened to Lucia's radio show since 1995 and had read his first two books. Tr. 336, 339. On cross examination, Chisholm testified that he had been to a BOM seminar "a couple years" before becoming a RJLC client, but he did not invest with RJLC as a result of the earlier seminar. Tr. 394-95. When questioned as to whether he opened his account with RJLC in February 2010, three weeks prior to attending his second BOM seminar, Chisholm recanted his earlier testimony and said, "I don't recall the

dates exactly." Tr. 412-414. Chisholm's resentment against Lucia and his willingness to offer less than truthful testimony is demonstrated by his statement, "I'm just thinking that it was the seminar that motivated me to buy these one way or the other." Tr. 416-17.[71] Ultimately, Chisholm admitted that he could have "initiated steps towards purchasing a REIT" based on the radio show, the seminar from two years prior, and his own Internet research, and stated, "I don't think I could swear as far as who or what was the first contact." Tr. 434-37.[72]

Significantly, Chisholm sent a letter to his congresswoman in early 2012 complaining about the REITs he had purchased through RJLC. Tr. 418, 432, 434-435, 437.[73] Although Chisholm took the effort to write to his congresswoman, his complaint did not assert that any misleading statement was made during the BOM seminar he allegedly attended. Tr. 418, 432. Consequently, prior to the filing of the OIP, the Division's investor witnesses took the time to complain to third parties about REITs they purchased through RJLC, but did not contend that they were misled at a BOM seminar.

2. The Illustrations Were Submitted To Multiple Layers Of Compliance Review.

Prior to use at a seminar, all marketing materials, including every slide in the BOM seminar slideshow was submitted to multiple layers of compliance review. Tr. 565-7, 1034,

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[71] Chisholm also admitted to communicating his issues with an Internet blogger who posted disparaging comments about Lucia. Tr. 426-429.

[72] Lucia Jr. testified that he reviewed RJLC's records which confirm that Chisholm attended two BOM seminars, the first in February 2006 and the second on March 2010. Tr. 1632. He became an RJLC client and made investments in REITs in February 2010. *Id.* He decided to have a BOM plan prepared and become an RJLC client as a result of Lucia's radio show, not a BOM seminar. *Id.* Chisholm called the Ray Lucia radio show and requested to speak with an RJLC advisor. *Id.* Accordingly, Chisholm's testimony provides no evidentiary basis for concluding the slides at issue misled any potential investor.

[73] Notwithstanding the fact that at the time of his REIT purchase, Chisholm understood REIT investments were "long-term – 10 years plus" and had "limited liquidity;" the REIT purchases were made just prior to the most severe downturn in real estate values in the history of the country, and he is still receiving rates of return far in excess of CD or money market rates, he complains that he was unable to sell his REITs two years after purchase at no loss. Tr. 409-413.

1053, 1077, 1305, 1691.[74] The seminar slideshow was reviewed by RJLC's supervising broker dealers, Securities America until 2007, and thereafter, First Allied, for FINRA advertising compliance purposes. Tr. 674-76, 1034, 1077, 1305, 1503, RX 29. Additionally, RJLC's internal compliance department also reviewed the seminar slides. Tr. 674. No concerns were ever raised that the slides might be misleading and any revisions requested by the broker dealers were made. Tr. 565-67. Both the November and December Reports for the 2010 Exam acknowledge that the seminar slides were submitted for compliance review, and assert that **First Allied failed to identify the marketing issues** in the Reports:

> [t]he examination disclosed that RJL submitted the marketing materials above to [its broker/dealer] First Allied for review and approval. However, it appears that First Allied did not test the accuracy of any performance returns presented in the marketing materials, and the First Allied review did not identify any of the marketing issues discussed above. The staff believes that an effective review of the marketing materials and the performance returns presented therein could have prevented the advertising issues discussed above, and the staff is bringing this to RJL's attention as a weakness in its compliance program. RX 50, RX 51.

Respondents also presented unrebutted evidence that Lucia never refused to make any change proposed by the RJLC or broker/dealer compliance departments. Tr. 682, 1281. Ochs never found Lucia to be uncooperative in the compliance process. Tr. 682. Lucia testified that if the broker dealer who reviewed and approved the Illustrations would have voiced an objection to the Illustrations, or if RJLC's internal compliance department had voiced an objection to any PowerPoint slide, he would have pulled the slide and never used it again. Tr. 1281.

3. The 2003 Exam Reviewed The Back-Test Slides And Concluded No Performance Advertising And Not Misleading.

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[74] See, RX 25-29, DX 24-49.

In 2003, examiners from the SEC's Pacific Regional Office examined the exact slides which the Division now contends warrant revocation of registration, an industry bar and third tier penalties and concluded that RJLC **was not engaged in performance advertising and raised no issues, concerns or questions regarding the '73 Illustration.** Although the 2003 examiners reviewed the seminar slideshow presentation and requested copies of certain slides, the examiners did not question or even request copies of seminar slides which 1) are labeled "back-test;" 2) utilize a 3% average inflation rate for the '73 to 2003 time period; 3) utilize a 7.75% REIT rate of return; and 4) do not deduct advisory fees. Further, the examiners did not question or raise any issue as to whether the '73 Illustration reallocated assets in a manner consistent with the BOM strategy. Tr. 1305. Where the SEC has examined identical marketing materials and come to two diametrically opposed conclusions, i.e., there is performance advertising vs. no performance advertising, should a man's 38 year career and the livelihood of his employees be destroyed because the SEC changed its mind?

SEC v. Slocum, 334 F. Supp.2d 144 (D.R.I. 2004), which is on point, provides authoritative support for a finding that Respondents did not act with the requisite scienter. In *Slocum*, the SEC conducted an examination of the registrant which failed to note any deficiency in registrant's account structure. *Id.* at 181. Six years later, the SEC conducted a subsequent examination resulting in alleged violations as to registrant's account structure. *Id.* The *Slocum* court found that the registrant's reliance on the SEC's evaluation was reasonable and, as a result, the SEC failed to meet is burden to prove scienter. *Id.* at 182. Further, in deciding whether an aiding or abetting violation of Section 206 of Advisers Act had occurred, the *Slocum* court held that the individual respondents did not act with scienter because neither the SEC examiners nor the firm's external auditors identified the firm's account structure as a potential problem. *Id.* at

185. "The evidence demonstrated that when potential compliance issues were brought to [the firm's] attention, [the respondent partner] took steps to remedy the situation by reformulating [the firm's] practices." *Id.*

The similarities of *Slocum* to this proceeding are unmistakable. As in *Slocum*, the Division examined RJLC's business and marketing practices in 2003, including the PowerPoint and the '73 Illustration, and expressed no negative comment as to the use of the slides that are now at the forefront of this proceeding. As in *Slocum*, Respondents assumed the '73 Illustration complied with all federal securities laws because the Staff's previous examination did not identify the '73 Illustration slides even potentially misleading. As in *Slocum*, when the Staff changed its position, Respondents immediately took remedial steps to cure any deficiencies. As in *Slocum*, Respondents also submitted the PowerPoint presentation to multiple layers of compliance review and made all changes requested by the broker/dealer compliance departments. Tr. Tr. 674-76, 1034, 1077, 1503, RX 29.

Had the 2003 examiners or the broker/dealer compliance departments advised Respondents that the Illustrations were misleading, or even potentially misleading, RJLC would immediately have pulled the '73 Illustration from the BOM seminar presentation – as it did with other slides during the course of and subsequent to the 2003 Exam and in December 2010 in response to the 2010 Exam Deficiency Letter. Tr. 1281.

4. The Illustrations Complied With The Industry Standard.

Respondents presented considerable unrebutted evidence that the '66 and '73 Illustrations comport with the industry standard. The industry standard for "back-tests" which illustrate historical returns with hypothetical distributions and inflation rates is found in marketing material disseminated by variable annuity companies, insurance companies and mutual fund

companies including Morningstar, Financeware, American Funds, Vanguard and Fidelity.[75] Tr. 837-838, 852-854, 903-904, 1093, 1269-1270, 1570-73, 1627-31; RX 46, 47, 59.

As testified to by Lucia, Plum, Stripe, and Lucia, Jr. the American Funds "back-testing" as presented in RX 46, is the industry standard for a "back-test" presentation of the effect of historical rates of return on hypothetical distributions – using a hypothetical average rate of inflation. Tr. 837-838, 852-854, 1093, 1269-1270, 1570-2, 1627-31. RX 46, which is advertising material disseminated by American Funds, is demonstrative of the industry standard. Grenadier testified that American Funds is a large mutual fund house with over a trillion dollars in assets under management. Tr. 973. RX 46, which is available to all potential investors, is titled "Selecting the Right Withdrawal Rate" and states that it addresses "one of the most frequent questions that investors in or near retirement asks, 'How much can I withdraw from my portfolio without depleting my savings over a long retirement?'" RX 46 contains two charts which illustrate American Funds "Back-testing" of that question. Chart 1 is labeled "Back-testing withdrawal rates on indexes" and tests 25 rolling 25-year periods from 1961-2010[76] using stocks and bonds based on historical index returns to represent the survival rate for a variety of asset mixes at withdrawal rates of 4%, 5% and 6%. The "Back-test" in Chart 1 uses a 4% average

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[75] Another example of the industry standard with respect to "back-tests" is exemplified by RX 59, the publicly available 2011 Financial Engines Income+ - A New Approach to 401(k) Retirement Income Whitepaper. Grenadier serves as a senior consultant to Financial Engines. Tr. 930. Like BOM, Financial Engines Income Plus is a retirement strategy for retirees. Tr. 958-9. RX 59 illustrates a number of hypothetical scenarios for retirees, including the "Nightmare" Equity Return Scenario which is referred to in the documents as a "back-testing analysis." RX 59, p .21-22. In this "back-test," retirement distributions were inflated during the decade beginning in 2000 at significantly less than one percent annually, while the actual annual inflation rate during that same time period averaged approximately 2.5% per year. Thus, the Financial Engines back test significantly under represents inflation. Further, no ending account balance was shown after 10 years of distributions, and there was no disclosure that investors could and likely would run out of money at some point in the future after accounting for actual, annual inflation. Finally it is not disclosed that eventually, the portfolio would be invested 100% in bonds. The Financial Engines back test is not consistent with Grenadier's testimony regarding misleading back-tests and the Division's position on proper back testing.

[76] This time period encompasses the BOM seminar '66 and '73 Illustration periods.

inflation rate for the period 12/31/61 to 12/31/2010 and does not deduct advisory fees or transaction costs.

Chart 2 is labeled "Back-testing withdrawal rates on select American Funds" has the same 25 year period from 1961-2010 and uses 11 American Funds equity funds to represent the survival rate at withdrawal rates of 4%, 5% and 6%. Chart 2 also uses a 4% average inflation rate from 12/31/61 to 12/31/2010. Charts 1 and 2 are instructive both use a hypothetical 4% average inflation rate for the historical period 12/31/61 to 12/31/2010.[77] The OIP alleges Respondents willfully violated Section 206 of the Adviser Act by using a hypothetical 3% inflation rate. OIP at ¶¶ 19, 22, 29, 30. Chart 1 fails to deduct advisory fees or to disclose the impact. The OIP alleges Respondents willfully violated Section 206 of the Adviser Act by failing to deduct advisory fees or to disclose the impact. OIP ¶¶ 23-25, 29, 30. RX 46 is unrebutted evidence that the '73 and '66 Illustrations comport with the current industry standards for "back-tests" which illustrate historical returns with hypothetical distributions and inflation rates and demonstrates that Respondents did not intend to deceive or mislead potential investors.

5. No Guidance By The SEC As To What Constitutes Misleading Performance Advertising Illustrations.

During the Hearing, unrebutted testimony was presented, including an admission by SEC examiner Bennett, that the **SEC has issued no guidance to investment advisers concerning performance advertising.** Tr. 145, 904-05, 1272-73. There is and always has been a shortage of genuine precedent to guide investment advisers as to what is legally prohibited under performance advertising. The Division's reliance on no-action letters and settlements only

[77] Grenadier testified that utilization of an average inflation rate over the period 1966 to 2003 would be misleading Tr. 965, 1011. His testimony demonstrates that while he may be familiar with the use of the term "back-test" and utilization of average inflation rates in an academic setting, he is not familiar with the current industry standard of such illustrations.

proves that the Division agrees with itself as to what is prohibited. A reasonable interpretative disagreement with the Division cannot form the basis of reckless conduct.

The standard the OIP assumes to show a violation of Section 206 is a substantial change in SEC policy that has never been communicated to investment advisers. The Division's idea of guidance seems to be instituting a proceeding making allegations with a factual predicate that has never been addressed by the SEC or any tribunal, and which completely obliterates – without recourse - a man and his heretofore successful business. This is not what courts, particularly the D.C. Circuit, recognize as due process.[78] For the foregoing reasons, the Division cannot demonstrate RJLC acted with scienter in violation of Rule 206(1).

E. RJLC Cannot Be Liable For A Violation Of Section 206(2) Because It Did Not Act With Negligence.

Recognizing that liability under Section 206(2) can be predicated on negligence, the Division has not met this burden. As demonstrated, when considered in context with the seminar presentation, the '73 and '66 Illustrations are not materially misleading. Seminar attendees understood that Lucia was comparing the difference in the longevity of retirement assets where there is a withdrawal of less risky assets before a withdrawal of riskier assets. See, *supra*, II.A. That is all. Lucia's presentation did not promote any specific assets or security, did not present performance calculations for any portfolio or managed account, and only discussed general asset categories. *Id.* Lucia repeatedly advised the attendees that the BOM withdrawal strategy was specific to each individual's income needs and retirement assets. *Id.* No misstatement or omission of material fact was made to the attendees and no investor was misled. See, *supra,* III.B.

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[78] This is the type of gross overreaching by the Division and the Commission that the D.C. Circuit Court has repeatedly reversed. See, *Marrie v. SEC*, 374 F.3d 1196 (D.C. Cir. 2004); *WHX Corp. v SEC*, 362 F.3d 854 (D.C. Cir. 2004), *Business Roundtable v. SEC*, 905 F. 2d 406 (D.C. Cir. 1990); *Checkosky v. SEC*, 23 F.3d 452 (D.C. Cir. 1994), and *Checkosky v. SEC*, 139 F.3d 221 (D.C.Cir.1998).

During the hearing, Respondents acknowledged that there were mathematical errors on the '73 Illustration. However, the Division presented no evidence that the errors were materially misleading. Moreover, in the December 2010 Exam Report, the Staff states that the ending balance presented for the BOM withdrawal strategy in the '73 Illustration was "was substantially lower than the staff's recalculation based on the hypothetical scenario . . ." RX 50, LA-SEC3937-005800, fn. 11. Accordingly, RJLC has not violated Section 206(2).

F. The Division Cannot Establish That Lucia Willfully Aided And Abetted RJLC In Violating Section 206(1)-(2) And (4) Of The Advisers Act.

In order to establish a claim for aiding and abetting, the Division must establish: (1) the existence of a securities law violation by the primary party; (2) "knowledge" of the violation on the part of the aider and abettor; and (3) "substantial assistance" by the aider and abettor in the achievement of the primary violation." *Metge v. Baehler*, 762 F.2d 621, 624 (8th Cir. 1985). "Irrespective of the level of proof required to establish the primary violation, the Commission has made clear that the accused aider and abetter must have acted with scienter." *In re FXC Investors Corp et al., supra,* 2002 WL 31741561, *9. Respondents have fully addressed the first element and second elements above. Simply put, the Division has failed to prove a securities violation by RJLC and Respondents presented unrebutted evidence that Lucia did not have "knowledge" of a securities violation. See, *supra*, III. A-D.

"[A]ctions against aiders and abettors of the securities laws, makes clear that the requisite scienter for aiding and abetting liability is 'knowingly.' This requirement is in keeping with the traditional scienter necessary to give rise to aiding and abetting liability under Section 10(b)." *SEC v. Fehn*, 97 F.3d 1276, 1295 (9th Cir. 1996). "The awareness of wrong-doing requirement for aiding and abetting liability is designed to insure that innocent, incidental

participants in transactions later found to be illegal are not subjected to harsh, civil, criminal, or administrative penalties. This policy is especially germane where the proscribed conduct of the principal may not always appear to be wrongful . . ." *Investors Research Corp. v. SEC*, 628 F.2d 168, 177 (D.C. Cir. 1980). "If the conduct is allegedly improper under the secondary liability theory of aiding and abetting, the protective function mentioned in *Investors Research* becomes applicable and an awareness of wrongdoing must be established." *Deckler v. SEC*, 631 F.2d 1380, 1388 (10th Cir. 1980).

The Division also fails to prove Lucia was reckless. See, *Howard v. SEC*, 376 F.3d 1136, 1143 (D.C. Cir. 2004) (Extreme recklessness . . . may be found if the alleged aider and abettor encountered red flags, or suspicious events creating reasons for doubt that should have alerted him to the improper conduct of the primary violator); *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 95 (5th Cir. 1975) ("Knowledge may be shown by circumstantial evidence, or by reckless conduct, but the proof must demonstrate actual awareness of the party's role in the fraudulent scheme."); *SEC v. Coffey*, 493 F.2d 1304, 1316 (6th Cir. 1974) ("the accused party had general awareness that his role was part of an overall activity that is improper"); *Investors Research, supra*, 628 F.2d at 179 ("the Commission failed to consider whether [respondent] had a general awareness that he was assisting [principal] in wrongful conduct").

As stated above, the Division cannot reasonably contend that Lucia should have been aware that presenting the '73 or '66 Illustrations was aiding any wrongdoing where the SEC reviewed the '73 Illustration in 2003 and did not raise any red flags that it was misleading; no RJLC investor ever complained about the Illustrations; no investor is alleged to had suffered any monetary loss as a result of a seminar, the Illustrations were submitted to multiple layers of compliance, the SEC offered no guidance as to performance advertising, and the OIP's

allegations are a substantial change in SEC policy that has never been communicated to the public. See, *supra*; III.A-D; *Slocum, supra,* at 334 F. Supp.2d 185.

G. The Division Presented No Evidence That Rule 204(4)-2(a)(16) Is Applicable To The Illustrations As The Calculations Therein Do Not Relate To The Performance Of Any Managed Account Or Securities Recommendation.

As the sole basis for an alleged violation of Rule 204(4)-2(a)(16), the OIP alleges that RJLC[79] failed to keep adequate records of alleged back-testing of the BOM strategy because certain the Spreadsheet calculations fail to duplicate the "performance calculations [presented at seminars] for several strategies which purport to demonstrate the superior performance of the BOM strategy over certain periods."

Rule 204(4)-2(a)(16) requires that an investment adviser maintain:

> all accounts, books, internal working papers, and any other records or documents that are **necessary to form the basis for or demonstrate the calculation of the performance or rate of return of any or all *managed accounts or securities recommendations* in any notice, circular, advertisement**, newspaper article, investment letter, bulletin or other communication that the investment adviser circulates or distributes, directly or indirectly, to 10 or more persons (other than persons connected with the investment adviser)... (emphasis added)

By its clear language, this Rule only applies to the advertised performance calculations of a managed account or securities recommendation. Moreover, all interpretations of this Rule by the SEC, Division, or any reported decision maintain this limitation. The Division presented no evidence that the BOM PowerPoint or the Illustrations contain performance calculations for any "managed account" or "securities recommendation." There are no managed accounts or securities recommendations referenced or alluded to in the seminar slide presentation. Tr. 142, 571, 572, 1274, 1281, 1284, 1594, 1597. Bennett testified that the "back-test" illustrations did not calculate the performance or rate or return of any managed account or securities

[79] This violation is not alleged against Lucia.

recommendation. Tr. 176-177. Lucia and Stripe corroborated Bennett's testimony. Tr. 1094-1095, 1340, 1594.[80] Finally, there are no reported decisions, SEC No-Action letters or other guidance in which the Division or the Commission has taken the position asserted here, namely that Rule 204-2(a)(16) is applicable to illustrations comparing various retirement withdrawal strategies which do not calculate the performance of a managed account or securities recommendation. Because the Illustrations do not calculate the performance of a managed account or securities recommendation, there is no requirement that books and records be maintained to support any calculations contained therein.

In *Salomon Brothers Asset Management, Inc. et al.*, 1999 WL 528854 (SEC No-Action Letter July 23, 1999)("*Salomon*"), the Office of Investment Management responded to Salomon Brothers' inquiry regarding sufficient documentation to demonstrate performance information for a managed account under Rule 204-2(a)(16). The *Salomon* response reiterates the Rule stating, "an investment adviser shall be deemed to have satisfied the requirements of the rule if, with respect to the performance of managed accounts, the investment adviser retains all account statements, if they reflect all debits, credits, and other transactions in a client's account for the period of the statement and all worksheets necessary to demonstrate the calculation of performance or rate of return of all managed accounts. *Id.* at p. 4. *Salomon* specifically provides examples of managed accounts as "registered or unregistered funds." *Id.* at p. 5, fn. 7.

There is no basis in fact or law to support a finding that the Illustrations or Spreadsheets contain calculations of the performance rate of return of any managed account or securities recommendation as those terms are used in Rule 204-2(a)(16) and interpretive guidance. See also, *Jennison Associates LLC*, 2000 WL 896020 (SEC No-Action Letter July 6, 2000)

[80] Not only are the slides at issue unrelated to managed accounts or securities recommendations, there is uncontroverted evidence that RJLC advisors *never recommended specific securities* to investors for their BOM plans. Tr. 732.

(recommending advisers maintain third-party records prepared by independent auditors to confirm the accuracy of internally generated records of **managed accounts**); *Horizon Asset Management, LLC*, 1996 WL 554956 (SEC No-Action Letter Sept. 13, 1996) (record keeping requirement applies to use of predecessor firm's performance data of **managed accounts**); *Great Lakes Advisors, Inc.*, 1992 WL 105179 (SEC No Action Letter Apr. 3, 1992) (denying portability of predecessor firm's performance data for **select portfolio securities**).

During the Hearing, in an apparent attempt unilaterally to expand the parameters of Rule 204(4)-2(a)(16), the Division struggled to elicit evidence that BOM is an "asset allocation portfolio," and to posit that the back-test slides were a "securities recommendation" or that an investor could purchase the BOM strategy. However, this contrivance is unavailing. Section 2(1) of the Securities Act defines a "security" as:

> any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

15 U.S.C. 77b(a)(1). Applying the SEC's definition of "security," neither RJLC nor Lucia made any "securities recommendation" during the BOM seminar. As there is no legal or factual basis for a violation by RJLC of Rule 204-2(a)(16), this claim should be dismissed.[81]

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[81] Respondents have consistently maintained this position in their response to the Staff's December 17, 2010 deficiency letter, Wells submission and Pre-Hearing Brief. For the past two years, the Division has offered no legitimate rationale for assertion of this purported violation. Because there is no requirement that RJLC maintain books and records necessary to demonstrate the calculations in the

H. Respondents' Affirmative Defenses Provide A Sufficient Basis For Dismissal Of The OIP.

1. Respondents Were Not On Reasonable Notice That The Commission Would Interpret Their Conduct To Violate Sections 206 Or 204 Of The Advisers Act.

"A fundamental principle in our legal system is that laws which regulate persons or entities must give fair notice of conduct that is forbidden or required." *FCC v. Fox Television Stations, Inc.* 567 U.S. ___, No. 10-1293 (U.S. June 21, 2012) Slip Opinion ("*Fox*"), *quoting, Connally* v. *General Constr. Co.*, 269 U. S. 385, 391 (1926) ("[A] statute which either forbids or requires the doing of an act in terms so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application, violates the first essential of due process of law"); *Papachristou* v. *Jacksonville*, 405 U. S. 156, 162 (1972) ("Living under a rule of law entails various suppositions, one of which is that '[all persons] are entitled to be informed as to what the State commands or forbids.'") *Id.* at Slip op. 11-12. "This requirement of clarity in regulation is essential to the protections provided by the Due Process Clause of the Fifth Amendment." *Fox, supra*, Slip op. 12, quoting *United States* v. *Williams*, 553 U. S. 285, 304 (2008). "It requires the invalidation of laws that are impermissibly vague." *Fox, supra*, Slip op. 12. "A conviction or punishment fails to comply with due process if the statute or regulation under which it is obtained 'fails to provide a person of ordinary intelligence fair notice of what is prohibited, or is so standardless that it authorizes or encourages seriously discriminatory enforcement.'" *Id.*

"[T]he void for vagueness doctrine addresses at least two connected but discrete due process concerns: first, that regulated parties should know what is required of them so they may

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seminar slides, the Spreadsheets (DX 12, DX 13) which consumed a significant portion of the hearing testimony and Grenadier's Report, are of little or no relevance.

act accordingly; second, precision and guidance are necessary so that those enforcing the law do not act in an arbitrary or discriminatory way." *Fox, supra*, at Slip op. 12, quoting *Grayned* v. *City of Rockford*, 408 U. S. 104, 108–109 (1972), see also, *Upton v. SEC*, 75 F.3d 92, 98 (2d Cir. 1996). Significant to the *Fox* decision is the Supreme Court's mandate that due process not only demands some level of clarity by the agency, but also that even if clear, the standard must be sufficiently precise as to not promote arbitrary or discriminatory enforcement.[82] *Fox, supra*, at Slip op. 12. In *Fox*, the Supreme Court found a due process violation where the FCC abruptly changed course to find a statutory violation. *Fox, supra*, at Slip op. 12.

With respect to deference to the Commission's interpretation of rules, there is substantial authority holding, "we cannot defer to the Commission's interpretation of rules if doing so would penalize an individual who has not received fair notice of a regulatory violation." *Upton, supra*, 75 F.3d at 98, *citing Lyng v. Payne*, 476 U.S. 926, 939, 106 S.Ct. 2333, 2341-42, 90 L.Ed. 2d 921 (1986) and *United States v. Matthews*, 787 F.2d 38, 49 (2d Cir. 1986), see also, *Marrie v. SEC*, 374 F.3d 1196, 1206 (D.C. Cir. 2004)("[f]air notice of the standards against which one is to be judged is a fundamental norm of administrative law: '[t]here is no justification for the government depriving citizens of the opportunity to practice their profession without revealing the standard they have been found to violate.'") citing *Checkosky, supra,* 139 F.3d at 221, 225–26 (D.C. Cir. 1998), see also, *General Electric Co. v. EPA*, 53 F.3d 1324, 1329 (D.C. Cir. 1995), *Lloyd C. Lockrem, Inc. v. United States*, 609 F.2d 940 (9th Cir. 1979).

In its recent opinion, *Christopher v. Smithkline Beecham Corp.* 567 U.S. ___, 132 S. Ct. 2156 (2012), the Supreme Court limited the deference given to federal agencies in interpreting

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[82] Respondents contend that the selective prosecution of the OIP is an effort to engage in rule-making by litigation where the Division would prefer to proceed against Lucia, instead of the behemoth mutual funds that use identical "back-tests." The vindictiveness of the Division's prosecution is evidenced by the severity of the penalties sought.

ambiguous federal regulations, especially in cases where an agency does not warn the public about major shifts in positions. In *Christopher*, despite acknowledging that the regulation at issue was ambiguous, and that Supreme Court precedent typically calls for deference to an agency's interpretation of its own ambiguous regulations, the Court withheld giving the agency's decision ***any*** deference where it "changed course" in its position. *Id.* at 132 S. Ct. 2166. The Court ruled:

> Petitioners invoke the DOL's interpretation of ambiguous regulations to impose potentially massive liability on respondent for conduct that occurred well before that interpretation was announced. To defer to the agency's interpretation in this circumstance would seriously undermine the principle that agencies should provide regulated parties fair warning of the conduct [a regulation] prohibits or requires. Indeed, it would result in precisely the kind of 'unfair surprise' against which our cases have long warned. *Id.*, 132 S. Ct. at 2166-67 (citations omitted.)

The holdings of *Fox* and *Christopher* are wholly applicable here where the evidence presented by Respondents conclusively establishes that: 1) the SEC has never issued any guidance as to performance advertising, nor has there ever been an opportunity for public comment;[83] 2) the Illustrations comport with industry standards, 3) the Division has never prosecuted an investment adviser for hypothetical illustrations which are a comparison of withdrawal strategies unrelated to any managed account or security,[84] and 4) in 2003, the Staff examined RJLC and, after reviewing marketing materials with identical issues to those in the OIP, determined there was no performance advertising and no securities violations, and in 2010, the Staff abruptly "changed course" and brought this proceeding. *See*, *supra*, II, III.C-D.

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[83] See, *Christopher*, *supra*, 132 S. Ct. 2169.

[84] For example, *Valicenti Advisory Services, Inc. v. SEC*, 198 F.3d 62 (2d Cir. 1999)(advertisement purporting to show rates of return on **client portfolio** excluded certain accounts to inflate advisor's performance); *SEC v. Richmond*, 565 F.2d 1101 (9th Cir. 1977)(adviser advertised the past performance of "Model Portfolio" which transacted in **specific stocks** without disclosing the transactions never occurred); *FXC,. supra*, (advisers failed to disclose that **actual performance of client accounts** was materially less than the model results for the period).

As articulated by the Supreme Court, **"[i]t is one thing to expect regulated parties to conform their conduct to an agency's interpretations once the agency announces them; it is quite another to require regulated parties to divine the agency's interpretations in advance or be held liable when the agency announces its interpretations for the first time in an enforcement proceeding and demands deference."** 132 S. Ct. at 2168.

Neither the SEC nor the Division has ever brought an action, articulated a position, or issued guidance that would suggest to an investment adviser that the conduct alleged in the OIP would provide a sufficient basis for a violation of Sections 206 or 204. Accordingly, these substantial and abrupt changes in enforcement policy were not reasonably communicated to the public and, therefore, in contravention of Respondents' due process rights, they did not receive reasonable notice that their conduct might violate Sections 206 and 204 of the Advisers Act.

2. This Administrative Proceeding Is Barred By The Statute Of Limitations.

Pursuant to 28 U.S.C. § 2462, the Division is required to bring this action "within five years from the date when the claim first accrued...."[85] Here, it is unrebutted that the SEC discovered the conduct at issue in 2003 and made a determination as to whether the conduct violated securities laws. Therefore, if the Division prevails and the court finds a violation of Rule 206(1), 206(2) or 206(4), the factual and legal prerequisites for bringing such a claim against Respondents were in place and the claim first accrued in 2003. Further, there is no alleged damage or harm to any investor and the relief sought effectively seeks to penalize Respondents for past conduct, the statute of limitations applies to all the claims asserted herein. *Johnson v. SEC*, 87 F.3d 484 (D.C. Cir. 1996).

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[85] On January 8, 2013, the Supreme Court heard oral argument in *SEC. v. Gabelli*, 653 F.3d 49 (2nd Cir. 2011), cert. granted, 133 S.Ct. 97, 183 L.Ed.2d 737 (U.S. Sept. 25, 2012) (No. 11-1274), on the issue of whether a claim "first accrues" (a) when it comes into existence, or (b) when the government discovers, or reasonably could have discovered the conduct at issue. Respondents reserve all rights which may be effected by the *Gabelli* decision.

IV. ASSESSMENT OF PENALTIES

Because the Division has failed to prove the violations alleged in the OIP, no disciplinary sanctions are warranted.

V. CONCLUSION

For the foregoing reasons, the OIP should be dismissed.

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